PROBLEMS IN MERCHANDISE DISTRIBUTION

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Problems in Merchandise Distribution

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FIRST EDITION
SIXTH IMPRESSION

McGRAW-HILL BOOK COMPANY, INC.
NEW YORK AND LONDON
1947

PROBLEMS IN MERCHANDISE DISTRIBUTION

PRINTED IN THE UNITED STATES OF AMERICA

PREFACE

This volume was initially projected as a successor to Learned's *Problems in Marketing*, published in 1936. The original plan for a revision to be published in 1940 was not carried through because Professor Stanley F. Teele, then at the head of the Marketing course at the Harvard Business School, was called to Washington on national defense work. As the national emergency developed, it became increasingly clear that the effects of a wartime economy on the business of merchandise distribution would be numerous and severe. The new marketing cases which were being collected took cognizance of these effects. Reviewing this situation early in 1942 in consultation with the publisher, the group charged with the conduct of the Marketing course at the Harvard Business School decided to pool their efforts and publish a new case book instead of deferring a revision until some uncertain date after the war.

The resulting volume has been entitled *Problems in Merchandise Distribution* in order to differentiate it somewhat from the earlier volumes in this case series. The fundamental philosophy, nevertheless, is the same as that of Learned's *Problems in Marketing*, and 38 of the 106 cases are reproductions or revisions of cases which appeared in that volume. The other cases, with four exceptions, have not been previously published.

The pedagogical objectives remain the same. By studying and discussing cases and problems, students are expected to acquire the ability to use facts in the analysis of business situations. This analysis should lead to action, since the purpose of such training is not primarily to convey information but rather to develop the capacity for management. The essential question either asked or implied in practically every case in this volume is "What action should the executives of the company take?" As a partial guide to these decisions involving action, students are expected to formulate currently useful generalizations about

marketing policies and practices from their study of groups of cases and from their reading and study of supplementary materials.

In this volume a brief introductory section of four cases is expected to convey an understanding of the nature and scope of present-day problems in the distribution of merchandise. Following this, there are two other sections, also partly introductory in character. The first of these is concerned with providing or sharpening certain analytical tools. Practically all persons who are engaged in the distribution of merchandise must deal constantly and precisely with such ideas and concepts as costs of goods, markups, markdowns, gross margins, operating expenses, net profits, rates of stock-turn, and the like. From teaching experience the authors have concluded that the most effective way for the student to obtain thorough mastery of these ideas and concepts is for him to study intensively such material as is presented in the note on operating statements, analytical ratios, and terms of sale and discounts, to work out and submit answers to the series of exercises appended (or similar ones which the instructor's ingenuity will readily suggest), and then to stand an examination, or a series of examinations, on this material. This particular piece of instruction may be undertaken at any point in the course which seems desirable. Experience at the Harvard Business School seems to indicate the advisability of the student's acquiring an early mastery of these tools.

The other section which is partly introductory in character is the group of problems on customer relations. The distribution of merchandise necessitates personal contacts at practically every stage; for the most part those who are engaged in marketing are dealing with people rather than with machines. Practically all distribution problems involve human relations, and this aspect always needs to be taken into account; but to drive home its importance to the student at an early stage in his study of distribution, several cases presenting problems of customer relations in a clear-cut form are placed together in one section.

After these introductory sections the major part of this case book represents the same general approach to distribution problems that has been characteristic of previous marketing case books, namely, the approach from the standpoint of the important business management functions in marketing: merchandising, channels of distribution, brand policy, sales promotion, marketing

organization and control, price determination, and price policies. To each of these a section of cases is devoted.

There are three remaining sections of cases, one on legislative regulation of prices, one on marketing trends, and a final one on diagnosis of marketing policies. The cases on legislative regulation of prices deal both with the controversial fair trade legislation of the 1930's and with some recent developments in wartime control of prices. In the section on marketing trends are included cases on the changing conditions affecting wholesalers, chains, supermarkets, and consumer cooperatives. Cases in the final group are not confined to any particular functional aspect of the distribution process, but are comprehensive problems embracing practically all aspects of marketing, and as such are designed to serve as a basis for review of the whole course. It will be noted that the cases in this section do not carry any questions, since the student is expected to make his own diagnosis of the issues and the pertinent facts.

The reasons for the joint authorship of this volume grew out of the circumstances of its preparation. As previously indicated, 38 cases were drawn from Learned's *Problems in Marketing;* and, in addition, Professor Learned, prior to relinquishing his responsibility for the Marketing course, supervised the collection of a substantial number of the new cases which here appear in print for the first time. Professor Teele, upon assuming the responsibility for the course, revised the outline and supervised the collection of many additional cases. After Professor Teele was called to Washington, the responsibility for the course devolved jointly on Professor Lewis and Professor McNair. When it was decided to publish a new case book, Professor McNair undertook to organize the work.

Many others besides the indicated authors have contributed to the publication of this case book. Most important is the contribution of the businessmen who have provided out of their experience the material for the cases in this book. This contribution, however, must remain anonymous; to avoid revealing identity, most of the cases are published under fictitious names. Many useful suggestions have been received from our present and former associates in the Marketing course, and from other members of the Faculty, including Professors Melvin T. Copeland, Charles I. Gragg, and Richard S. Meriam, and the new Dean of

the School, Professor Donald K. David, who has long been engaged in marketing activities. Most of the material for the new cases presented herein was obtained by John H. Martin, Instructor in Marketing, and John J. Cummings, Associate in Research. Mrs. LeRoy M. Hersum and Miss Elinor Perry were responsible for preparing the manuscript and reading the proof.

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SOLDIERS FIELD,
BOSTON, MASSACHUSETTS,
July, 1942.

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I

NATURE AND SCOPE OF MARKETING PROBLEMS

1. M. E. JAYSON

DIRECT DISTRIBUTION OF EGGS

During the spring of 1940, M. E. Jayson contemplated selling direct to consumers in the city of Phoenix the eggs produced on his near-by ranch.

Phoenix, with a population of approximately 50,000, was the largest city in Maricopa County. Glendale and Mesa, the two next largest cities, with populations of about 4,000, were 10 and 15 miles, respectively, from Phoenix. The U.S. Census of Distribution for 1935[1] listed 245 retail food stores in Phoenix, with total annual sales of $6,003,000, or annual sales per capita of $125 and annual sales per store of $24,500.

When Mr. Jayson had purchased the ranch, in 1931, the only land under cultivation was 10 acres of grapefruit and oranges. In the following year, a larger irrigation system was installed and 80 acres of grapefruit and 3 acres of dates planted. Three years were required for the grapefruit and five years for the dates to reach a point of maturity that would yield a marketable crop. In 1935, when the grapefruit were ready to market, Mr. Jayson disposed of the crop through the facilities of the Arizona Grapefruit Cooperative. This Cooperative took the crops of all its members and sold the fruit in eastern markets at the best prices possible. At the end of the year, after a fee had been deducted for administration, advertising, and shipping costs, the proceeds were distributed on a prorata basis.

For several years Mr. Jayson spent the greater part of his time away from the ranch; but in 1938 he took up residence there and personally assumed charge of the ranch's operations. Believing

[1] U.S. Bureau of the Census, *Census of Business: 1935, Retail Distribution* (Washington, the Bureau, 1936), Vol. III, p. 86.

that a ranch should produce a variety of crops, he had planted lemon trees in 1936, and in 1938 he raised a flock of turkeys. In May, 1939, he purchased 300 chicks with the expectation of selling eggs; and during the fall of that year, he planted a few acres of grain to be used as feed for the chickens and turkeys.

In an effort to take over part of the distribution of his produce, Mr. Jayson stopped selling his grapefruit through the Cooperative in 1938 and undertook to sell them direct to truckers, who hauled the crop to the large cities in southern California. The grapefruit raised on the Jayson ranch were an especially high-quality Arizona variety, and in Mr. Jayson's opinion it was reasonable to expect them to command a premium price in the city markets. He believed that, by establishing his contacts directly and not allowing his fruit to be merged with that of a great many other producers, he would have a better chance of obtaining this premium price. In fact, he seriously considered the possibility of establishing some roadside stands in San Diego to sell the grapefruit at retail. The turkeys were sold to the country club and to a large hotel in Phoenix, as well as to several retailers in the city. Since there was not a large enough market near by to absorb the dates produced on the ranch, he sold this crop by direct-mail solicitation to persons in all parts of the United States.

During the winter of 1939–40 the eggs from the 300 chicks that had been purchased in the spring were sold in Phoenix to the country club, to a large hotel, and to three retailers. Mr. Jayson's experience during this season convinced him that there was a profitable market for eggs in the Phoenix region. In the spring of 1940, therefore, he purchased 2,000 more chicks. While making plans for the distribution of a greatly increased number of eggs, Mr. Jayson considered the possibility of selling the eggs direct to users in Phoenix. In the city there were stores of a national grocery chain, a chain of supermarkets, and several independent supermarkets. Mr. Jayson believed that, although these stores provided a grocery distribution system at about as low a cost as could be expected, the markup on fresh produce such as eggs was sufficiently high to afford him an opportunity for additional profit by undertaking the retailing function. Accordingly he wrote to J. H. Held, an acquaintance who had had experience in the development of marketing policies for a variety of industries. The correspondence culminated in the following letter:

Phoenix, Arizona
May 12, 1940

DEAR MR. HELD:

In your letter of May 5 you mentioned more data which you would need to be of help to me in the problem which I put up to you some time ago, *i.e.*, to determine whether we could afford to deliver eggs direct to users, namely, housewives, as against our present plan of selling to grocers. You also raise certain questions about our other crops. In the first place, let me say that while we hope to sell some grapefruit, and some dates as well, directly to housewives, these sales would be a small part of our total output of these fruits. We will have to depend on other means of distribution to dispose of these crops. It would be of no value, then, to burden you with information about them.

As to eggs, the problem resolves itself purely to one of determining whether, if we sold and delivered direct to the housewives, our costs would enable us to make a profit out of the margin that the retailer now marks up his eggs, and with which he has to pay his costs and obtain a profit. The better dealers here mark up their eggs 6 cents a dozen, out of which they must take 1 cent for the carton, leaving 5 cents to cover the normal retailing costs and leave a profit.

Our problem, then, is to determine what our delivery, sales, and associated costs would be. Since writing, we have got some line on delivery costs by conference with men who carry on delivery services in Phoenix. There are two services here which will deliver a package in the city limits for 10 cents per delivery. For the quantity of business which we could give them, one of them has offered a rate of 8 cents for bicycle delivery, while another proposes truck delivery at 9 cents. A third service thinks it can be done for 5 cents a delivery if they can use Motorglides, a little single-cylinder motorcycle equipped with a sidecar delivery basket, from which they have been getting 150 miles to the gallon of gasoline. The fly in the ointment is that this service is not well financed and we doubt the efficiency of the management. But the equipment cost is so low that, with routes on which we will have two and three stops per block, we might be able to get the delivery charge near this figure. We may have to buy and operate the equipment ourselves.

We think that we can count on an average delivery of two dozen eggs per customer per week, so that if we could get our delivery cost down to 5 cents per delivery, it would come to 2½ cents per dozen.

The additional costs would be sales, billing, collection, and credit losses. Since we put out only the highest-quality eggs we would not seek trade except among the better-class families, who would not only have the requisite purchasing power but can be appealed to by quality solicitation. The number of likely prospects is in the neighborhood of 700, for that is the number of property owners whose improvements are carried on the tax rolls as valued at $10,000 or more. Our

sales plan is to send personally addressed letters to prospects, followed by telephone calls.

If we had to get all our volume at once through direct sales, the plan would be expensive and possibly prohibitive. But we can easily dispose of our entire output through hotel, restaurant, and dealer channels which we now serve, so that we will add the private trade only as fast as we can get it economically. A factor working in our favor is that it is next to impossible to get thoroughly satisfactory eggs here in midsummer and the early fall. We expect to handle them in such a way that the quality will be tops, even in that period. Because of these considerations we are placing the cost of adding an account at only 50 cents, which would be ridiculously low under other conditions. Spreading this over the first year's business (80 dozen to a customer) would give us a cost of 0.6 cents per dozen. Since we have confidence that we will be able to hold the trade year after year, the cost over a longer period would be less.

Customers will be billed monthly. We feel we can do this because we shall select the names of those whom we shall solicit, and will be quite sure of their credit. Credit losses we put at 1%, which on a volume of 80 dozen per customer per year (2 dozen for 40 weeks) would be 0.3 cents per dozen. We have no figures on the cost of billing but estimate that it can be done for 0.5 cents a dozen on a volume of 300 dozen moved through these channels per week, or somewhat more than 1,200 dozen per month. Customers will pay by check. We find that this is their preference.

Summarizing, we have these costs per dozen:

Delivery	2.5 cents
Selling	0.6
Billing and Collection	0.5
Credit Losses	0.3
Total	3.9 cents

This would show a profit of 1.1 cents per dozen as against selling to dealers.

We have spread all the costs, you will note, over the eggs; but we hope to sell dates and grapefruit to the same customers and on the same deliveries.

You will appreciate from this outline that it would be of little value, so far as the solution of our problem is concerned, to load you with a lot of figures about the production costs of eggs or of these other items. The ranch is there. It is producing these products. We are disposing of them through the usual outlets at present. The problem is whether we would benefit by establishing an additional method of distribution.

And let me say finally that I thank you heartily for your kindness in offering to help.

Sincerely,
M. E. Jayson

Should Mr. Jayson have undertaken the sale of eggs direct to consumers?

2. BLADE MASTER, INC.

MARKETING A NEW PRODUCT

In April, 1937, the officers of Blade Master, Inc., were confronted with the problem of setting a price and working out a detailed marketing program for their product. The Blade Master was a new type of razor blade sharpener. Through consumer tests the officers had established its salability, and they were convinced that a substantial market existed for the product.

The Blade Master was originally developed and patented in Europe, where a large and powerful corporation had put it on the market in several countries. Over a period of years prior to 1936, 400,000 units had been sold at a retail price equivalent to $2.75; the product was given no advertising or special promotion beyond small window and counter display cards. Because of high duties, no Blade Masters had been imported into the United States or Canada; consequently the product was entirely unknown to the American public.

In 1934, A. C. Weston, an architect and designer, happened to purchase a Blade Master while traveling in Europe. He was so impressed with its merits that he made a visit to the offices of the corporation which owned the patent to determine what plans, if any, had been made for distribution of the product in the United States. When he learned that no serious consideration had been given such a proposal, he began negotiations to obtain the exclusive rights to manufacture and sell the product in the United States and Canada for the life of the patent. The Blade Master was based on a new combination of principles, which provided an extremely strong patent position; and Mr. Weston considered of some importance the fact that the European corporation was willing to join with a licensee in the defense of the patent in the United States.

Mr. Weston was successful in his negotiations, and upon his return to this country he took immediate steps to ascertain the costs of reproducing the European article in the United States. He found that, because the product was a precision instrument and made of

highest-quality materials, a manufacturing cost of slightly more than $1 would be necessary. Believing that any selling price which could be set on this basis would substantially limit the market, Mr. Weston undertook to reduce this cost estimate by substituting materials, by redesigning, and by changing methods of manufacture. Over a period of 18 months he was able to bring the cost down to approximately 60 cents when parts were bought in quantities sufficient to make 500 Blade Masters.

In developing the product, Mr. Weston was unable to find any manufacturers willing to incur the expense of making up dies. Accordingly he invested his own money to the extent of some $6,000 in dies, molds, and tools, which were used by the manufacturers who agreed to make the various parts. Upon completion, these parts were shipped to Mr. Weston in New York, where he assembled them with the assistance of a helper.

Mr. Weston recognized the value of consumer tests, and in the middle of 1936 he began to distribute a small number of Blade Masters on a consignment basis among retail stores of various kinds. Since his resources were running low, he was forced to make collections for sales before he could afford to buy new parts. Through the comments of store proprietors and the reaction of customers, several difficulties were brought to his attention and eliminated. All Blade Masters sold through retail stores were priced at $1.50; and although no advertising of any kind was used, 2,000 sharpeners were sold in this manner, all but 300 of them during the period from July to October, 1936.

In the fall of 1936, Gregory Barlow, a junior partner in a firm engaged in promoting new enterprises, happened to notice a display of Blade Masters while visiting a tailor shop. He bought one and was so pleased with it after several trials that he returned to purchase another as a gift for his father. At this time he met Mr. Weston; and on learning in the course of general conversation the facts presented above relating to the product, Mr. Barlow agreed to undertake the sale of the rights to manufacture and sell the Blade Master. After approaching several manufacturers and finding their response enthusiastic, he concluded that direct exploitation of the product would be more profitable than sale of the rights. Mr. Barlow therefore entered into negotiations with several capitalists interested in financing new products and ultimately worked out a

plan which provided $100,000 working capital for the new enterprise. Thus Blade Master, Inc., was formed, and both Mr. Barlow and Mr. Weston agreed to devote their efforts to promoting the sale of the product.

One of the first steps taken by the men was to interest a prominent cutlery store in Radio City in stocking the Blade Master. This firm sold four dozen in the week before Christmas. By February 1, more than 200 inquiries had been received from all sections of the country, many resulting from purchases made at this store by visitors to New York. Another experiment involved selling the product in the Fifth Avenue unit of a prominent men's clothing chain. Four dozen were sold in a day and a half. In both these retail establishments the selling price for the Blade Master was $1.50; the cost price to the stores was $9 per dozen in one instance and $10.80 in the other.

During the period between December, 1936, and April, 1937, a number of concerns sought exclusive distributorships for various sections of the country. One large company expressed interest in buying 100,000 units to be used in a combination offer with its own related product. This interest was contingent on a wholesale price permitting a retail price of $1 for the Blade Master. Two large drug chains indicated that they would be interested in retailing the sharpener at $1.49 if a satisfactory margin were provided. The officers were encouraged by these proposals, although they doubted that such interest represented a typical attitude of chain stores. A small razor blade manufacturer suggested a joint radio advertising campaign over a local station based on the sale of sharpener and blades together. Buyers for several large New York department stores approached the company because their European buying offices were referred to it by the European corporation. Although the company was not prepared at the time to accept such orders, the proposals convinced Mr. Weston and Mr. Barlow that a large potential market existed, provided a satisfactory retail price and adequate dealer margins could be worked out.

The Blade Master was submitted to several well-known marketing executives in New York City for opinions as to its salability and as to the most profitable price. There was general agreement as to its salability, but suggested retail prices ranged from $1 to $5. Mr. Weston had seen the results of a survey made in 1935, which indi-

cated that total sales of razor blade sharpeners in the United States in 1934 had approximated 1,500,000, of which about 700,000 were the output of a single company.

In April, 1937, Blade Master, Inc., planned to continue buying all parts from individual manufacturers, because the dies were already owned and this policy permitted some flexibility. It was undecided whether to establish its own assembly plant later or to contract with another concern to assemble the parts. The manufacturer of one of the chief parts had adequate facilities for assembling the complete product. On the other hand, almost no investment was necessary for the company to do its own assembling. A small loft equipped with chairs, benches, and screw drivers was all that was required. On the basis of his own work, Mr. Weston was certain that an unskilled girl could assemble 15 units an hour. Whatever the final decision might be, the officers planned to continue the assembling in a small room until marketing plans had progressed to the point where sales ran above 100 units a day.

On the basis of prices submitted by parts manufacturers, the officers estimated that costs could be reduced from about 60 cents to 40 cents as soon as it became possible to place orders for 10,000-unit runs, and to 25 cents if 100,000-unit runs could be ordered.[1] The dies and molds owned by the company in April, 1937, permitted an output of parts for 1,000 Blade Masters a day. Approximately two months would be required for the preparation of dies and molds to increase output to a point above this level.

Should the management have proceeded further with this project?

What should have been the general marketing program?

3. VAN RAALTE COMPANY, INC.

INTERPRETATION OF SPECIFICATIONS IN ARMY CONTRACT

On July 13, 1940, the Philadelphia Depot of the Quartermaster Corps sent out invitations for bids on 200,250 yards of 35-inch cotton mosquito netting and 262,500 yards of 81-inch cotton mosquito netting, the netting to be made on tricot machines. The

[1] This cost included the cost of parts, packages, the directions enclosed, assembly, and shipping cartons. It did not include any selling or overhead costs beyond these.

Van Raalte Company, a warp knit[1] manufacturer, received this invitation on July 14. The bids were to be opened at 9 a.m., July 25, 1940, at the Quartermaster Depot in Philadelphia.

The specifications required by the War Department for this material were as follows:

Weight per square yard, minimum 1.5 ounces
Meshes per square inch, approximately 196
Breaking strength (grab method used), minimum: length 18 pounds, width 12 pounds
Shrinkage, maximum percentage: length 8%, width 16%

The War Department had originally established these specifications for bobbinet netting.[2] Since there were relatively few bobbinet machines in the United States, the Philadelphia Depot had sought a substitute for bobbinet machines and had settled upon tricot machines. This change had opened up a large source of supply because tricot machines were used extensively in the United States in the manufacture of knitted underwear and other knitted garments.

The specifications stated further that the netting was to be made of cotton of suitable length and grade, thoroughly cleaned, well combed, evenly spun, and twisted into a yarn of suitable count to meet these specifications. The Quartermaster Corps recommended to the tricot manufacturers that the yarn be made of either 55/1 or 60/1 cotton. It specified that the netting should be knitted and finished in such a manner that the stretch in the direction of the length would be reduced to a minimum. The finished netting was to be clean, well made, and free from unmended drop stitches, oil stains, and any other defects or imperfections which might impair its service or durability. Delivery of 50% of the order was required within 60 days; total delivery was to be completed within 90 days from the date of the receipt of the award.

Because of the lack of time, it was physically impossible for the Van Raalte Company to make samples. Although the tricot industry had never made any goods of this type for the Army, the

[1] Warp knit is the product of either tricot or milanese knitting machines; these machines have one to five warps which are knitted by the action of needle bars and needles. The cloth produced is mostly runless.

[2] Bobbinet netting is the product of a particular kind of machine, related to the lace machine, which operates with warps and flat brass bobbins held in place by gear tooth carriages. These carriages traverse around the warp threads and intertwist with them in such a manner as to form a hexagonal mesh.

Van Raalte Company wished to have a part in the defense program and was most anxious to cooperate with the government. As soon as the specifications and details were received, they were sent to the manufacturing division of the company. In the short time at its disposal, the company worked out its bids and mailed them to the Philadelphia Depot in time to be included in the award.

On July 30, the company learned that it had been awarded a contract for 140,250 yards of 35-inch netting and 30,000 yards of 81-inch netting. The company was asked to submit samples for approval before continuing with the contract. After working on the samples for several weeks, the officials of the company decided that it was impossible to meet the requirements set by the government. They learned for the first time that the specifications set by the War Department were for mosquito netting previously made on bobbinet machines. Because of the differences between bobbinet machines and tricot machines, it was impossible to use the same set of specifications for both types of machines. These specifications, in fact, contradicted the physical properties of the material manufactured on tricot machines. In addition, there were two main difficulties to be overcome in manufacturing the netting on tricot machines. First, in order to meet the shrinkage percentage required by the specifications, the hole count had to be increased well over the specified figure of approximately 196 holes per square inch; this increase brought the hole count to from 240 to 250 holes per square inch. Second, if the hole count was satisfactory, the shrinkage percentage could not be met.

After working on this problem for three weeks, the officials of the company realized that what the Quartermaster Corps considered as shrinkage was actually contraction; after being washed, the tricot netting could be pulled back into its original form. The officials made several visits to the Quartermaster Depot in Philadelphia to discuss their difficulties and finally convinced the authorities there that all the requirements which were necessary for satisfactory mosquito netting could be met by tricot machines, but that the original specifications made it impossible for the company to meet the requirements which were established when the contract was awarded. The company submitted samples of materials that it considered thoroughly satisfactory. After testing these samples, the officials at the Quartermaster Depot informed the company that its contentions were correct and that a liberal interpretation would

be given to the specifications set by the War Department. The liberal interpretation of the specifications was as follows:

Weight per square yard, minimum 1.5 ounces
Meshes per square inch, minimum 190, maximum 220
Breaking strength (grab method): length 16 pounds, width 10 pounds
Shrinkage, maximum percentage 32% over all

An additional difficulty faced by the Van Raalte Company was the impossibility of producing perfect netting on tricot machines. In a piece of material approximately 45 yards in length, some imperfections would be caused by breakage of the cotton or of the machine. A satisfactory piece of cloth would contain five or six imperfections, which would be impossible to mend perfectly. The fact that the Quartermaster Corps imposed a penalty of 1⅓ yards allowance for every imperfection was learned only after the award had been made; this fact had not been taken into consideration in the original bid.

Imperfections resulted whenever a thread broke in the machine. The operator stopped the machine as soon as he detected a break, but each operator tended four machines. Executives of the company estimated that a delay of only 30 or 35 seconds would result in an imperfection 1½ inches long. The Quartermaster Depot ruled that imperfections which were not over 1½ inches long and which were properly mended would not be subject to the penalty clause. It was exceedingly difficult, however, to avoid a number of slightly longer imperfections, and the company sought to have the tolerance increased to 2 inches.

What factors are important in dealing with the government as a customer?

Should the Van Raalte Company have handled its relations with the government any differently?

4. HARVARD COOPERATIVE SOCIETY, INC. (B)

OPERATING PROBLEMS IN WARTIME

In May, 1942, the general manager of the Harvard Cooperative Society, Inc., in common with the executives of retail stores generally, faced many problems of adjusting the store's operations to meet

wartime conditions. In spite of difficulties in securing merchandise, it was clear that the Society would close the fiscal year ending June 30, 1942, with one of the most successful showings in its history, from the standpoint both of sales volume and of net profit to be distributed among its membership. The period ahead, however, was not promising. The almost certain imposition of increased restrictions on the production of civilian merchandise, the pronouncement of the "General Maximum Price Regulation" by the Price Administrator, and the growing pressure by the government to reduce civilian purchases indicated that continued profitable operation could be secured only by careful control of operating costs, strict effort to obtain an adequate gross margin, and alertness to buy and promote such merchandise as was obtainable.

At the moment, the General Maximum Price Regulation[1] was the source of numerous problems. The management of the store desired to adhere not only to the letter but to the spirit of the regulation, yet it saw the need of taking whatever action was possible within the provisions of the regulation to prevent the store's gross margin from being reduced to unprofitable levels.

The following instances illustrate some of the problems stemming from the price regulation.

The stationery department faced a loss of gross margin on certain packaged items of notebook paper which it sold in large quantities to students. These particular papers had been stocked and priced to meet the competition of near-by variety chains. The package of 8½- by 11-inch sulphite paper in greatest demand contained 75 sheets, and until the middle of May had sold at 10 cents. It had cost the store 6.4 cents. The package label carried the Society's imprint and gave the number of sheets enclosed. In January, 1942, the buyer for the stationery department had had to contract for further supplies, in view of the fact that his stock at that time would last only until May or June. Knowing that prices of paper had risen, he shopped the near-by chains to learn their prices, but found

[1] The General Maximum Price Regulation provided that on and after May 18, 1942, no commodity or service might be sold or delivered at a price higher than that charged for the same commodity or service during the month of March, 1942. In cases where the seller did not deal in the same or a similar commodity or service during March, 1942, the maximum price was to be the highest price charged for the particular commodity or service in March by the most closely competitive seller of the same class [Sec. 2(b)(1)].

For the full text of the General Maximum Price Regulation and the supplementary regulations covering summer and fall seasonal goods, see pp. 562–578.

that at the time they were not selling the notebook paper in question. As he had foreseen, the price of the paper had increased; and in order to secure a markup near that which he had obtained previously on the item, it was necessary under the new contract to reduce the number of sheets in the 10-cent package to 60. He contracted at a price of 6.75 cents a package for a supply of these packages, bearing new labels, sufficient to last until January, 1943, with delivery to be made between May and August, 1942.

On the basis of the March selling prices, it was evident that this package of 60 sheets would have to be sold at 8 cents. A store shopper found on May 18 that the near-by chains were selling this grade of notebook paper in packages of 55 sheets for 10 cents. When the chain store clerks were questioned, they said that the number of sheets in the package had been reduced before March. The chain store label did not designate the number of sheets contained in the package.

Two alternatives of seeking relief from the resulting low markup were open to the management. It might attempt to persuade the supplier to give a lower price than 6.75 cents a package. It anticipated, however, that the supplier would point out that the price given in the contract was a January price, that paper prices had tended to stiffen subsequently, that the company's costs had increased, and that its earnings in the recent period had been relatively small.

The second alternative was to seek an adjustment from the Office of Price Administration, according to procedure outlined in the regulation, on the ground that the March price was abnormally low in relation to the prices of the same commodity among competing sellers, and that to adhere to this price would entail hardship. It was anticipated that to carry through on the basis of the reduced margin imposed by the March ceiling would reduce the net operating profit of the store on this one package alone by several hundreds of dollars.

A problem as to the interpretation of the price regulation was involved in the case of an advertised brand of men's summer suits which had been a leading seller in the store for some years. The Harvard Cooperative Society had sold none of these suits during March, but it had sold some during the early part of May for $19.50, which was the contract resale price of the manufacturer. The store management was uncertain of the price applicable to these suits as

of May 18, when the price ceiling went into effect. The question was whether these suits should be treated as seasonal merchandise for which, under a ruling of the Office of Price Administration, the average markup in 1941 might be taken over the cost, or whether they should be priced, under Section 2(b)(1), at the manufacturer's fair-trade price, on the ground that this was the price established by competition. The buyer for men's suits pointed out that these suits had sold at $19.50 in Florida and southern states during March but that he had not been able to learn of any sales made at this price in Boston or in near-by cities. Application of the 1941 markup to the purchase price gave a price of $18.81. The buyer found, however, that Boston stores on the morning of May 18 generally were offering the suit at $19.50, the manufacturer's contract resale price. He therefore set his price at $19.50.

A different type of problem arose in the case of men's clothing for fall. In May a line of men's suits was being offered at $48.50, which was also the March selling price. These suits had cost the store $29.10. Orders had already been placed for these suits for the fall season at a cost to the store of $33. Under the March price ceiling these suits presumably would have to be priced in the fall at $48.50. The management believed that in this instance there would probably be a "roll-back"; in other words, that there would be an adjustment whereby the clothing and perhaps the textile manufacturers would absorb some of the "squeeze" on margin resulting from the regulation. The extent to which the store might receive relief through such an adjustment would depend on the extent to which the margins and profits of the various producers and distributors in the industry permitted them to share in the price adjustment. While this problem was under consideration, the OPA issued Regulation 153, effective on May 29, 1942, setting as the maximum price for fall outer garments for women, girls, and children the highest price charged by the particular seller for a garment of substantially equal workmanship and quality during the period July 1–September 30, 1941. A similar order relating to men's and boys' apparel was expected to be issued shortly.[1]

In the group of departments selling kitchenware, electrical appliances, radios, household appliances, and so on, a serious problem arose from shortages of merchandise. One after another, these

[1] Maximum Price Regulation 153 as originally issued proved to be unworkable and was amended early in June. The principal features of the amended regulation

goods had become difficult to buy or even unobtainable. By forward buying, the store had secured a stock of electrical appliances which would carry it through the summer, with a loss of sales of only 20% to 25%. What items could then be obtained was uncertain, but there was no doubt that supplies would be greatly reduced. The management believed, moreover, that there would be difficulty in finding other merchandise to replace such lines, in view of the fact that rationing was likely to be extended to numerous types of merchandise.

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were as follows:

(1) The handling of price lines higher than any carried for the preceding fall selling season was prohibited.

(2) The bar to changes in quality and workmanship was removed.

(3) Manufacturers were permitted to include in their costs actual costs of materials up to June 14, 1942, or subsequent replacement cost, whichever was lower. and increases in wage rates pursuant to any wage agreements entered into up to April 27, 1942. They were permitted to add to these costs the normal percentage of markup for the corresponding lines for the preceding fall selling season.

(4) Wholesalers and retailers in cases where cost price lines were unchanged from the preceding fall selling season were permitted to use the selling price in effect for the preceding fall selling season for the bulk of the goods sold in the particular category and price line. In cases where cost price lines were not the same, wholesalers and retailers were required to determine their maximum prices by adding to their costs the average initial dollar markup on the next lower cost price line during the preceding fall selling season; or, in the absence of such a lower cost price line the average initial percentage markup on the next higher cost price line of the preceding fall selling season or the average percentage markup in the department, whichever was higher. In the case of garments bought by wholesalers or retailers at prices below customary established cost price lines, the maximum price was to be determined on the basis of cost plus average initial dollar markup on garments of the same category for the preceding fall selling season. In other words, savings in purchase costs had to be passed along to consumers.

Maximum Price Regulation 177, covering men's and boys' ready-made tailored clothing, was issued early in July, effective on July 11, 1942. For men's and boys' clothing exclusive of outer coats, the provisions of the General Maximum Price Regulation obtained and the ceiling was set at the highest price charged in March, 1942. On topcoats and overcoats the retailer was permitted to take the highest price charged during September, October, and November, 1941; or, if no charge was made for the same garment, then the price for the nearest similar garment, plus 14% of that part of the price which was not more than $50 and plus 8% of that part of the price which was more than $50.

With reference to similarity, the wording of the regulation was as follows: "One garment shall be considered similar to another garment if the first is in the same classification as the second, has the same use, is made with equivalent workmanship, and contains materials and trimmings which are of the same type and quality and would ordinarily sell at substantially the same price. In determining similarity, differences merely in design, and differences owing to compliance with WPB Conservation Order No. M 73 A of March 2, 1942, shall be disregarded except that a one-pant suit shall not be considered similar to a two-pant suit." Thus, taken literally, the order called for maintained quality. Amended Regulation 153, on the other hand, covering women's, children's, and girls' outerwear garments, frankly made provision for the manufacturer to recover his added labor costs through a diminution in quality.

The ski department presented a different type of problem. For some years this department of the store had been very successful. The 1941 sales of the ski department, for instance, had been in excess of $20,000.[1] In anticipation of the 1942 season, the buyer had purchased skis and ski equipment sufficient, when added to the inventory remaining from the 1941 season, to give an opening stock of $15,000.[1] Beginning on May 15, 1942, gasoline was rationed along the Atlantic seaboard. Skiers thus were precluded from using their automobiles to reach even near-by slopes; and indications were that rationing of railroad travel might shortly be inaugurated. Inability to dispose of the stock of skis and ski equipment might prove serious in the event of any government action to control store purchasing on the basis of the relation of current inventory to the sales volume of some earlier period. At the end of May, 1942, it was widely rumored that the War Production Board would set up a storewide control of inventory on the basis of relation to the 1940 sales volume.

What action should the management have taken on these various problems?

[1] Figure altered to prevent disclosure.

II

OPERATING STATEMENTS, ANALYTICAL RATIOS, AND TERMS OF SALE AND DISCOUNTS

INTRODUCTION

Many of the facts on the basis of which decisions in marketing problems are reached are expressed in figures. Accordingly, some of the essential procedures, ratios, and meanings of terms are presented here in brief form.

THE RETAIL OPERATING STATEMENT

An operating statement, or profit and loss statement, is a summary of operations for a specific period of time. The period covered may be a year, a half-year, a quarter, a month, or even a week; but annual, semiannual, and quarterly operating statements are the most common.

The elements of the operating statement for a retail business may be explained as follows: A retailer buys merchandise from manufacturers or wholesalers at one price and sells it to the public at a higher price. Out of the difference between his sales and the cost of the merchandise to him, the retailer pays the wages of salespersons, rent, and other expenses. If these expenses do not use up all the difference, the retailer has a profit. These relationships, which constitute the essence of the operating statement, may be illustrated as follows:

Sales	$100,000
Cost of Goods Sold	70,000
Gross Margin	$ 30,000
Expenses	28,000
Net Profit	$ 2,000

During the period, the merchant had sales of $100,000; the merchandise which he sold cost him $70,000; hence the spread was $30,000. This spread, or difference, is now generally called the "gross margin," although the older term "gross profit" is still used in some

trades. Thus, *sales minus cost of goods sold equals gross margin; gross margin minus expenses equals net profit.*

Gross Sales—Net Sales. Customers sometimes return merchandise to stores after they have purchased it, either because it is defective in some respect or simply because they have changed their minds. In such an event, the store may accept the merchandise and refund the money, or it may make an adjustment in the price. The former procedure results in a "return"; the latter, in an "allowance." Returned merchandise is generally restored to salable condition and placed in stock for sale to others.

At the time when sales are made, the retailer does not know what merchandise will be returned. Accordingly, the total of sales shown on the sale slips and/or the receipts recorded by the cash registers are taken as the "gross sales." From this figure are deducted returns and allowances, and the resulting figure is called "net sales." The figure for net sales represents the real volume of business done, out of which the merchant must pay for his goods and meet his operating expenses. The relationship between gross sales and net sales may be illustrated as follows: Assume that a retailer sells ten dresses at $10 each and that four dresses are returned by customers. At this point the merchant's gross sales are $100, his returns $40, and his net sales $60. The merchant then sells the four returned dresses at $10 to other customers. At this point his gross sales are $140, his returns $40, and his net sales $100. But one additional dress is returned, and he makes an allowance of $5 on another. At this stage his gross sales are still $140, but his returns and allowances have increased to $55 and his net sales have decreased to $85. Finally the remaining dress is sold at $10 and is not returned. Therefore the figures are: gross sales $150, returns and allowances $55, and net sales $95.

In a retail operating statement, gross sales and returns and allowances appear at the beginning. Taking the skeleton form outlined on page 17 we now have:

Gross Sales	$110,000
Returns and Allowances	10,000
Net Sales	$100,000
Cost of Goods Sold	70,000
Gross Margin	$ 30,000
Expenses	28,000
Net Profit	$ 2,000

Cost of Goods Sold. If a retailer began business during a period with a stock of merchandise, made absolutely no purchases during the period, and ended the period with bare shelves, the cost of goods sold would be simply the cost of the merchandise purchased by the merchant for his initial stock. But in a going retail business this is never the situation. The retailer has a stock of goods, called an "inventory," both at the beginning and at the end of the period; and this inventory must be taken into account in computing the cost of goods sold. Moreover, the retailer is constantly purchasing new merchandise. The procedure, therefore, is simply to add together the inventory at the beginning of the period and the purchases during the period and to subtract from this sum the inventory at the end of the period. These figures are normally included in the operating statement as follows:

Gross Sales		$110,000
Returns and Allowances		10,000
Net Sales		$100,000
Opening Inventory at Cost	$ 40,000	
Purchases at Cost	80,000	
Cost of Goods Handled	$120,000	
Closing Inventory at Cost	50,000	
Cost of Goods Sold		70,000
Gross Margin		$ 30,000
Expenses		28,000
Net Profit		$ 2,000

Thus, *opening inventory at cost plus purchases at cost minus closing inventory at cost equals cost of goods sold.* The sum of opening inventory and purchases is called the "cost of goods handled." Opening inventory is sometimes called "beginning inventory," "inventory at beginning," or "inventory as of a certain date"; similarly, closing inventory is sometimes called "ending inventory," "inventory at end," or "inventory as of a certain date."

Valuation of Inventories. An examination of the preceding sample operating statement will show that the value assigned to the closing inventory has a direct effect on the gross margin, and therefore on the net profit during the period. (Of course, since the closing inventory of one period is the opening inventory of the following period, the valuation of the closing inventory also affects the figures for the succeeding period.) If the value assigned to the closing inventory in the illustrative operating statement were reduced from

$50,000 to $40,000, the cost of goods sold would be $80,000, the gross margin would be $20,000, and the net profit of $2,000 would become a net loss of $8,000. Conversely, if the valuation of the closing inventory were increased from $50,000 to $60,000, the cost of goods sold would be $60,000, the gross margin $40,000, and the net profit $12,000.

The valuation of an inventory is frequently far from a simple procedure. In a store carrying homogeneous merchandise, such as shoes, it is relatively simple to maintain unit merchandise records which will show precisely what merchandise is in stock at the end of the year and thus enable the merchant, by reading the cost prices from these records or by tracing back the invoices, to determine just how much these goods cost him. For stores carrying a wide variety of items, particularly items of low unit value, the maintenance of such unit records is not feasible, and a vast majority of stores do not have them. There are, therefore, two principal methods of inventory valuation followed by retailers: the "cost-or-market" method and the "retail" method.

The cost-or-market method involves recording on the price tag, usually in code, the cost of the merchandise to the retailer. At the end of the period, the merchandise in stock is counted (the process is called "taking a physical inventory"), and the aggregate cost value is computed by multiplying the number of items in stock by the costs shown. This total is the closing inventory at cost. But there is ordinarily in most retail trades a question whether the merchandise in stock at the end of the period is still worth what the retailer paid for it. If a grocer bought canned soup in November for $1.08 a dozen and the manufacturer is still quoting that price on December 31 when the retailer takes inventory, the stock of soup can undoubtedly be valued properly in the inventory at $1.08 per dozen. But if between November and December 31 the manufacturer has made a permanent reduction in price to 98 cents a dozen, there is a serious question whether the retailer, if he uses the $1.08 cost, will have an accurate statement of his inventory, gross margin, or net profit. Most retailers therefore use the basis of inventory valuation which is summarized in the phrase "cost or market whichever is lower." On this basis the merchandise is valued at the cost to the concern or at the current market price, depending on which is lower. In the example just cited, therefore, the retailer would use the "market" price of 98 cents, that is, the price at which the merchan-

dise can currently be purchased. If the manufacturer had advanced his price to $1.18 a dozen, the retailer would use the cost of $1.08, because that is lower than the prevailing market price. When a retailer uses this method, the closing inventory (and therefore the opening inventory of the next period) is "at cost or market."

The other principal method of inventory valuation, the so-called retail inventory method, used in most department stores, numerous chain stores, and other large-scale retail enterprises, involves the maintenance of a running book inventory at both cost and retail, the recording of all price changes, the taking of physical inventory at retail rather than at cost, and the reduction of the retail inventory figure to a cost basis through the application of percentage relationships. In its refinements this method is rather complicated, and an understanding of it is not necessary for ordinary distribution problems.

Purchases and Cash Discounts. A "cash discount" is a reduction in the price of merchandise offered to secure prompt payment of bills. The cash discount terms may be stated as a percentage of the

CASH DISCOUNTS TREATED AS "OTHER INCOME"

Gross Sales		$110,000
Returns and Allowances		10,000
Net Sales		$100,000
Opening Inventory at Cost	$ 40,000	
Purchases at Billed Cost	80,000	
Cost of Goods Handled	$120,000	
Closing Inventory at Cost	50,000	
Cost of Goods Sold		70,000
Gross Margin		$ 30,000
Expenses		28,000
Operating Profit		$ 2,000
Other Income: Cash Discounts Taken		2,000
Net Profit		$ 4,000

CASH DISCOUNTS TREATED AS A REDUCTION IN COST OF MERCHANDISE

Gross Sales			$110,000
Returns and Allowances			10,000
Net Sales			$100,000
Opening Inventory at Cost		$ 40,000	
Purchases at Billed Cost	$80,000		
Cash Discounts Taken	2,000		
Purchases at Net Cost		78,000	
Net Cost of Goods Handled		$118,000	
Closing Inventory at Cost		50,000	
Cost of Goods Sold			68,000
Gross Margin			$ 32,000
Expenses			28,000
Net Profit			$ 4,000

price, as a fixed dollar amount, or as fixed dollar amounts per unit. The first is the more usual procedure, very common terms being a 2% discount for payment within 10 days from the date of invoice. These terms on the invoice (bill) are usually written 2/10. Cash discount terms may also be stated as 50 cents a gross for immediate payment, and the like. There are a great variety of cash discount terms used in different trades, variations appearing both in the percentage reductions and in the length of period during which they may be taken. (See additional examples in the section on Terms of Sale and Discounts, pages 31–35.)

There is a controversy of long standing as to the proper handling of cash discounts in the operating statement. One group holds that a cash discount represents income received by the business because it is financially able to pay its bills promptly. The other group holds that a cash discount is more properly considered a reduction in the price paid for merchandise. These two points of view are reflected in the two operating statements shown on page 21. The tendency among large retailers at the present time is to treat cash discounts as a merchandise earning; practice among manufacturers and wholesalers is more mixed.

Purchases and Inward Transportation Charges. It has become customary to include the cost of freight, express, postage, and truckage incurred in getting merchandise from the vendor to the merchant as a part of the cost of the goods rather than as an expense. These items, called collectively "inward transportation charges," are paid sometimes by the vendor (manufacturer, wholesaler, or importer) and sometimes by the merchant. When paid by the vendor, transportation charges are, of course, included in the price

Gross Sales			$110,000
Returns and Allowances			10,000
Net Sales			$100,000
Opening Inventory at Cost		$ 40,000	
Purchases at Billed Cost	$80,000		
Cash Discounts Taken	2,000		
Purchases at Net Cost	$78,000		
Inward Transportation Charges	3,000		
Purchases at Net Cost Delivered		81,000	
Total Cost of Goods Handled		$121,000	
Closing Inventory at Cost		50,000	
Cost of Goods Sold			71,000
Gross Margin			$ 29,000
Expenses			28,000
Net Profit			$ 1,000

paid by the merchant. When the merchant pays these charges, they are added to the cost of purchases in the operating statement.

A complete operating statement based on the explanation thus far is shown on page 22.

Classification of Expenses. The part of the operating statement from gross sales to gross margin is frequently called the "merchandise statement," and the remainder, the "expense statement." To facilitate the control of operations, it is customary to classify expenses. There are in use a variety of classifications of expense. One type is based on the kind of expenditure, for example, salaries and wages, rent, supplies, advertising, and the like. This type of expense classification is illustrated in the following profit and loss statement:

Gross Sales			$918,740
Returns and Allowances			40,360
Net Sales			$878,380
Opening Inventory at Cost		$176,890	
Purchases at Billed Cost	$565,452		
Cash Discounts Taken	24,595		
Purchases at Net Cost	$540,857		
Inward Transportation Charges	11,858		
Purchases at Net Cost Delivered		552,715	
Total Cost of Goods Handled		$729,605	
Closing Inventory at Cost		165,685	
Cost of Goods Sold			563,920
Gross Margin			$314,460
Total Pay Roll		$146,230	
Rent		37,770	
Advertising		30,743	
Taxes		5,410	
Interest (including interest on owned capital)		23,716	
Supplies		11,419	
Service Purchased		7,027	
Unclassified:			
Losses from Bad Debts		4,392	
Other Unclassified		13,786	
Traveling		4,392	
Communication		5,400	
Repairs		3,514	
Insurance		6,080	
Depreciation		5,350	
Professional Services		3,072	
Total Expense			308,301
Net Profit			$ 6,159
Net Other Income (including interest on owned capital)			20,192
Net Gain before Federal Tax on Income			$ 26,351

Another type of expense classification is based on the purpose for which the expenditure is made. For instance, in such a profit and loss statement as that shown on page 24 for a wholesale grocery business,

the wages of receiving and shipping force, outward freight and express, and outward truckage are added together to form a total receiving and shipping expense. Other similarly classified groups of expense in this statement are total selling expense, total management and buying expense, and total fixed charges and upkeep. This type of expense classification helps to place the responsibility for expense control on particular members of the organization.

Gross Sales			$3,354,033
Returns and Allowances		$ 125,522	
Cash Discounts Given		14,913	140,435
Net Sales			$3,213,598
Beginning Inventory at Cost		$ 501,605	
Purchases at Billed Cost	$2,618,253		
Cash Discounts Taken	22,551		
Purchases at Net Cost	$2,595,702		
Inward Transportation Charges	51,688		
Purchases at Net Cost Delivered		2,647,390	
Total Cost of Goods Handled		$3,148,995	
Closing Inventory at Cost		497,776	
Cost of Goods Sold			2,651,219
Gross Margin			$ 562,379
Commissions and Expenses of Salesforce	$ 193,780		
Advertising	2,892		
Other Selling Expenses	964		
Total Selling Expense		$ 197,636	
Wages of Receiving and Shipping Force	$ 25,387		
Outward Freight and Express	35,670		
Outward Truckage	25,387		
Total Receiving and Shipping Expense		86,444	
Executive Salaries	$ 47,883		
Office Salaries	28,601		
Postage and Office Supplies	10,605		
Telephone and Telegraph	5,142		
Credit and Collection Expense	2,892		
Total Management and Buying Expense		95,123	
Interest on Borrowed Capital	$ 25,709		
Interest on Owned Capital	23,781		
Rent	13,818		
Heat, Light, and Power	8,998		
Taxes	4,499		
Insurance	3,534		
Repairs of Equipment	2,571		
Depreciation of Equipment	1,606		
Total Fixed Charges and Upkeep		84,516	
Losses from Bad Debts		12,856	
Other Unclassified		15,423	
Total Expense			491,998
Net Profit			$ 70,381
Other Income: Interest on Owned Capital			23,781
Net Gain before Federal Tax on Income			$ 94,162

THE WHOLESALE OPERATING STATEMENT

Wholesalers are engaged in buying merchandise from various types of suppliers and reselling it to retailers and certain large-scale users such as institutions. Accordingly, in its major elements the wholesale operating statement is similar to the retail operating statement. As shown in the illustrative operating statement on page 24, one of the differences is in the item "cash discounts given." The retailer selling to the public seldom allows cash discounts. Therefore the only cash discount item on the retail operating statement is that of cash discounts taken by the retailer on purchases from manufacturers, wholesalers, or other suppliers. The wholesaler, however, not only secures cash discounts on his purchases from manufacturers and others but also grants cash discounts to his customers. In the wholesaler's operating statement, cash discounts taken are treated essentially as in the retail operating statement. Cash discounts given to customers, however, appear as a deduction from gross sales.

Wholesalers are likely to make use of expense classifications somewhat different from those used by retailers. The statement on page 24 represents a partly functional expense classification. But either natural or functional expense classifications may be used by both retailers and wholesalers.

THE MANUFACTURING OPERATING STATEMENT

The manufacturing operating statement is not standardized to the same extent as are the retail and wholesale operating statements. Among manufacturers the concepts of cost of goods sold and gross margin are not so sharply defined as they are among retailers and wholesalers. Some manufacturing concerns treat the cost of purchased materials and parts plus wages of workmen as cost of goods; others add factory overhead to these items; while still others include in cost of goods all costs except those for advertising, selling, and

Gross Sales		$1,100,000
Returns and Allowances		100,000
Net Sales		$1,000,000
Cost of Materials	$250,000	
Manufacturing Costs	350,000	
Manufactured Cost of Goods Sold		600,000
Gross Margin		$ 400,000
Marketing Expenses	$200,000	
Administrative and General Overhead Expenses	150,000	350,000
Net Profit		$ 50,000

general administration. Subject to this lack of standardization, a manufacturer's operating statement may be visualized as composed of the elements shown on page 25.

However the manufacturing cost may be figured, the spread, or difference, between that cost and the manufacturer's net sales is commonly thought of as the manufacturer's gross margin, out of which he must take marketing expenses, administrative and general overhead expenses, and all other expenses before arriving at net profit.

ANALYTICAL RATIOS

Use of Percentages. For comparing the operations of one period with another, or of one concern with others, it is highly desirable to express the various items in the operating statement as percentages. For many reasons, which need not be detailed here, net sales have very generally been adopted as the base, or 100%. For example, if net sales are \$100,000 and the cost of goods sold \$60,000, the gross margin is $\frac{\$40,000}{\$100,000}$, or 40%; it is *not* $\frac{\$40,000}{\$60,000}$, or 66⅔%. This is true whether the problem is that of a manufacturer, a wholesaler, or a retailer. *Therefore, unless otherwise indicated, when markup, gross margin, any expense item, or profit is stated as a percentage, it is a percentage of the net sales of the particular concern or group of concerns, whether the business be manufacturing, wholesaling, or retailing.* (For purposes of instruction in the Harvard Business School, this rule may be considered absolutely invariable.)

Computation of Markup. When a merchant buys an item of merchandise for resale, he puts a selling price on it, that is, the price for which he hopes to sell it. This price exceeds the cost paid by the merchant by what is called the "markup," or the "markon." The basic general conception that the selling price is composed of two parts, the cost of the merchandise and the markup, is shown in Diagram A.

DIAGRAM A

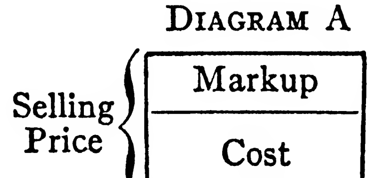


Diagram B illustrates a specific situation where the cost of the merchandise is 60 cents, the markup is 40 cents, and the selling price is \$1.

Diagram B

Selling Price = $1	Markup = 40¢
	Cost = 60¢

For many purposes it is useful to have the markup expressed as a percentage. Theoretically the 40-cent markup might be expressed either as a percentage of the cost or as a percentage of the selling price. If it were expressed as a percentage of the cost, the markup would be 66.67%; that is, the 40-cent markup divided by the 60-cent cost equals 66.67%. When it is expressed as a percentage of the selling price, the markup is 40%; that is, the 40-cent markup divided by the $1 selling price equals 40%.

If the cost is known and the percentage of markup on selling price is given, it is a simple matter to compute the selling price. Suppose, for example, that a retail merchant buys goods at a cost of $10. He desires to use a markup of 33⅓% in order to cover his expenses and have some chance of making a net profit. What should be the selling price? An answer of $13.33 is wrong, because the markup is on selling price, not on cost. The first step is to remember, as illustrated in Diagrams A and B above, that the selling price is made up of two parts, the cost and the markup, and that when the selling price is taken as 100%, this means that the cost and the markup together must add to 100%. Therefore, if it is known that the desired markup is 33⅓%, it follows that the cost must be 66⅔%. The cost is known to be $10. Hence $10 equals 66⅔% of the selling price. What is 100%, or the selling price? Obviously, it is $10 ÷ 66⅔% = $15. (This procedure is equivalent to dividing $10 by 66⅔ to find out how much is 1% and then multiplying by 100, that is, shifting the decimal point two places, to find out how much is 100%.) Similarly, if a wholesaler buys an article for 60 cents, desiring a markup of 20%, the selling price is 75 cents.

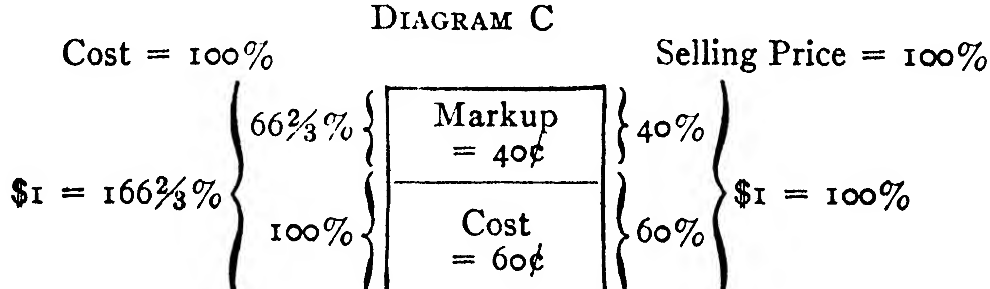
It is to be emphasized that markup and gross margin percentages are figured on the selling price at each level of business. Thus, if the cost of an article to a manufacturer is 75 cents and his desired markup is 25%, his selling price is $1; if the wholesaler to whom the manufacturer sells wishes to use a markup of 16⅔%, his selling price will be $1.20; and if the retailer who buys this article from the wholesaler resells it to consumers at $2, his markup will be 40%.

Although the percentages which are in daily use in business are calculated on the basis of selling price, it is necessary for the businessman to understand the relationships between percentages on selling price and percentages on cost and to know how to convert from one base to the other. On merchandise costing \$10 and selling for \$15, the markup is \$5. This markup, which is 33⅓% of the selling price, would be 50% if computed on the basis of the cost. Thus we say that a markup of 33⅓% on selling price is equivalent to a markup of 50% on cost (and the same thing, of course, is true if the percentages are gross margins instead of markups). Most businessmen, particularly merchants, usually carry in mind such common relationships as the following:

Markup on Selling Price		Markup on Cost
16⅔%	=	20%
20	=	25
25	=	33⅓
33⅓	=	50
40	=	66⅔
50	=	100
75	=	300

It is useful to know how to make conversions of percentages from the selling-price base to the cost base and vice versa. This procedure is simple if it is always remembered that selling price is composed of two parts, namely, the markup and the cost. In Diagram C we know that the markup is 40% of the selling price. The cost

Diagram C



therefore must be 60%. Now if we wish to express the markup not as a percentage of the selling price but as a percentage of the cost, we simply divide 40% by 60% (that is, by the difference between 100% and 40%), getting the answer 66⅔%. There is an unvarying relationship here which may be embodied in the following formula:

$$\frac{\text{Percentage Markup on Selling Price}}{100\% - \text{Percentage Markup on Selling Price}} = \text{Percentage Markup on Cost}$$

Suppose now that it is desired to reverse this procedure. We know that the markup is 66⅔% of the cost, which is now taken as 100%; but we desire to express this markup as a percentage of the selling price. When markup is 66⅔% of cost, it follows that the total selling price must be 66⅔% plus 100%, or 166⅔%. Hence if it is desired to express the markup as a percentage of the selling price, it is necessary to divide 66⅔% by 166⅔%, which operation yields the answer 40%. This aspect of the relationship of percentages may also be expressed in an unvarying formula, as follows:

$$\frac{\text{Percentage Markup on Cost}}{100\% + \text{Percentage Markup on Cost}} = \text{Percentage Markup on Selling Price}$$

Markdowns. It often happens that the merchant is unable to sell merchandise at the original selling price and is forced to reduce the price. The amount of the reduction which he takes is called a "markdown." A merchant buys an article for 60 cents and marks it to sell at $1; thus the original, or initial, markup is 40 cents, or 40% of the original selling price. He is unable to sell it for $1 and reduces it to 90 cents, taking a 10-cent markdown. He sells it for 90 cents and thus secures a gross margin of 30 cents (90 — 60), or 33.33% of net sales. The markdown of 10 cents, although it might logically be considered as a markdown of 10% from the original selling price, is commonly expressed as a percentage of net sales. Thus, in the foregoing illustration, the markdown of 10 cents is $\frac{\$0.10}{\$0.90}$, or 11.11% of net sales. It should be emphasized that the total amount of markdowns taken in a period, that is, the dollar amount of reduction on each item times the number of items reduced in price, is customarily computed as a percentage of the net sales in the period, without regard to whether markdowns were taken on all items or only on part of the items and without regard to whether the marked-down items have been sold or still remain in stock. Thus if a retail clothing merchant buys ten men's suits at $24 each and prices them to sell at $40, and if he sells eight at that price during the period and marks the other two down to $30, at which price he sells one, his net sales are $350 and his markdowns $20, or approximately 5.7%.

Markdowns do not appear in the operating statement, because the operating statement begins with gross sales and markdowns occur before sales are made. Needless to say, goods are sold at the

current price at which they are marked, and sales are recorded at those prices, no matter what prices may have been marked on the merchandise at some earlier time. Although markdowns do not appear in the operating statement, separate markdown records are kept by most progressive merchants and are regarded as a highly significant measure of the efficiency with which a merchandising business is operated. Because markdowns are a common occurrence in practically all merchandising businesses, it is necessary to plan rates of original markup, or markon, that are higher than the expected rates of gross margin.

Stock-turn. Another frequently used measure of the efficiency with which a store is operated is the "rate of stock-turn." The rate of stock-turn is simply the number of times the average inventory is sold during a given period. Stock-turn rates are most commonly computed for a year, but they may be reckoned for six months or even for a month or less.

The stock-turn rate may be computed by dividing the average inventory at cost into the cost of goods sold, by dividing the average inventory at selling price into the net sales, or by dividing the average inventory in physical units into net sales in physical units. To illustrate, assume that a merchant begins a period with 100 suits which cost $20 each and are marked up to a selling price of $30 each. During the period other suits are purchased for resale, and at the end of the period he has in stock 60 suits which cost him $16 each and carry a selling price of $24 each. For the period his net sales of 360 suits amount to $9,990; the cost of goods sold is $6,660. The stock-turn rate can be computed from these figures in three ways:

Opening Inventory at Cost	$2,000
Closing Inventory at Cost	960
	2)$2,960
Average Inventory at Cost	$1,480
Cost of Goods Sold	6,660

$$\frac{\$6{,}660}{\$1{,}480} = 4.50 \text{ times} = \text{Stock-turn Rate}$$

Opening Inventory at Selling Price	$3,000
Closing Inventory at Selling Price	1,440
	2)$4,440
Average Inventory at Selling Price	$2,220
Net Sales	9,990

$$\frac{\$9{,}990}{\$2{,}220} = 4.50 \text{ times} = \text{Stock-turn Rate}$$

Opening Inventory in Units	100
Closing Inventory in Units	60
	2)160
Average Inventory in Units	80
Net Sales in Units	360

$$\frac{360}{80} = 4.50 \text{ times} = \text{Stock-turn Rate}$$

It is essential that both the numerator and the denominator of the final fraction should be in the same terms: If average inventory *at cost* is used, it must be divided into *cost of goods sold;* if average inventory *at selling price* is used, it must be divided into *net sales;* if average inventory in physical units is used, it must be divided into net sales in physical units.

TERMS OF SALE AND DISCOUNTS[1]

Terms of sale vary among different industries, among different trades, and even among different companies, with the result that interpretation of any set of formal terms must depend to a large extent on practices within the industry, trade, or company to which these terms are being applied. Nevertheless, certain fundamental definitions relating to the terms of sale can be formulated, and the more common practices outlined.

Terms of sale include two factors, "dating" and "discount." Dating refers both to the time before which the specified amount of discount may be taken and to the time at which payment for the merchandise will become due. Discount, as the term is used in retail distribution, is any reduction in price allowed the purchaser of merchandise by the seller. The most common types of discount are cash discounts, quantity discounts, trade discounts, and arbitrary discounts used as devices for varying quoted prices.

A "cash discount" is a reduction in price allowed the buyer for prompt payment. It is expressed as a percentage of the total amount due the seller, that is, of the billed price after deduction of trade, quantity, and arbitrary discounts. A very common type of cash discount is illustrated by the terms "2/10 net 30." The terms in this example mean that the purchaser may take a 2% discount if he pays the bill within 10 days after the date of the invoice, and that, if he does not pay the discounted bill within 10 days, he is expected

[1] Reprinted, by permission, from Malcolm P. McNair, Charles I. Gragg, and Stanley F. Teele, *Problems in Retailing* (New York, McGraw-Hill, 1937), pp. 178–184. See also John W. Wingate, *Manual of Retail Terms* (New York, Prentice-Hall, 1931), Chap. VI; and National Retail Dry Goods Association, Personnel Group, *Arithmetic for Executive Training Groups* (New York, the Association, 1931), Chap. I.

to pay the full amount within 30 days. After 30 days, the bill will be considered overdue and may be subject to an interest charge.

Sometimes the date before which a discount may be taken is reckoned not from the date of the invoice but from some other date specified in the terms. For instance, the terms might have read "2/10 E.O.M.,"[1] in which case the 2% discount would be allowed not only for 10 days after the date of the invoice but for 10 days after the end of the month in which the invoice was made out. Whereas an invoice dated March 5 with terms 2/10 net 30 must be paid by March 15 if the discount is to be taken, on an invoice of the same date with terms 2/10 E.O.M. the discount may be taken up to April 10. When terms are written E.O.M., purchases made after the twenty-fifth of any month are regarded by many sellers as of the following month, so that an invoice dated March 27 with terms 2/10 E.O.M. may in many cases be paid as late as May 10 instead of April 10.

Convenience is the reason for E.O.M. dating, as it is for another type of dating called "R.O.G.[2] dating." E.O.M. dating is practical because it is convenient for purchasers to pay a number of bills, or all bills from a single resource, on the same day of the month. R.O.G. dating is used when a purchaser is located at a considerable distance from his resource, since, in this event, if terms are based on the date of invoice, payment may become due before the merchandise is received. Payment before receipt and inspection of the merchandise may lead to dissatisfaction and to the need for adjustment. Under R.O.G. dating, therefore, the days for allowing discount are numbered from the date the goods are received by the purchaser instead of from the date of the invoice.

A similar type of dating is seasonal dating, in which the terms specify the date from which the period for allowing discount is to be computed. For example, seasonal merchandise purchased July 1 may be billed "3/10—September 1," in which case the discount will be available until September 10. Seasonal dating is advantageous to the seller in that it saves warehousing expense, induces early buying of seasonal goods, and enables the producer to keep his plant operating in slack seasons. It is advantageous to the buyer because he may purchase early in the season but make payment only after his own sales of the merchandise have begun.

[1] End of Month.
[2] Receipt of Goods.

The date of payment for merchandise may also be affected by another practice, called "extra dating." Extra dating means that the discount will be allowed for a certain period in addition to that first mentioned in the terms; for example, 2/10-60 x (extra) means that the 2% discount may be taken not only for 10 days but for 60 extra days, or 70 days in all from the date of the invoice.

These types of dating are commonly called "advance" or "post" dating; that is, the date of payment is advanced into the future, so that payment need not be made until after the time indicated by the date of the invoice.

When a purchaser pays his bill before the due date, he may be entitled by the terms of the contract express or implied[1] to deduct, in addition to the allowed discount, interest for the days by which he "anticipates" the due date. Anticipation is usually computed at 6% per annum.

A "quantity discount" is a reduction in price allowed the buyer for a purchase of or above a specified amount. There are three types of quantity discount. The discount may depend upon (1) the quantity of a single item purchased; (2) the total quantity of all items purchased on a single order; or (3) the quantity purchased during a season or over some other specified period of time. In either of the first two cases the discount is referred to as a quantity discount and may be deducted before the invoice is entered as a purchase for the store or department. Such a discount sometimes consists of free goods. In the third case the discount is designated as a period discount, a patronage discount, a deferred discount, or a cumulative quantity discount, and may take the form of a cash rebate, a merchandise credit, or free goods.

A "trade discount" is a reduction in price given to a certain category of customer to cover the cost of performing a particular trading function. The amount of the trade discount may or may not appear on the face of the invoice. If it does not, then the trade

[1] In actual practice, anticipation is allowed by a majority of the resources with which department stores and other large retailers deal. A purchaser has no legal right, however, to take anticipation unless that is part of the contract express or implied, that is, unless the right to take anticipation is noted on the invoice, or unless anticipation is an established custom of the trade, an established practice of the parties concerned, or otherwise a part of the agreement between purchaser and seller. Part I, Sec. 3, of the Uniform Sales Act includes the following clause: "Subject to the provisions of this act and of any statute in that behalf, a contract to sell or a sale may be made in writing (either with or without a seal), or by word of mouth, or partly in writing and partly by word of mouth, or may be inferred from the conduct of the parties." A sale for which there is no contract is legally for cash.

discount has already been deducted from the manufacturer's catalogue or list price to arrive at the price billed on the invoice. If, on the other hand, the merchandise is billed at the manufacturer's catalogue or list price, then the discount may appear at the foot of the invoice as a percentage of the billed price. This billed price is the list price and frequently the manufacturer's suggested retail price.

Arbitrary discounts are ordinarily allowed purchasers by sellers either to vary selling prices without changing quoted or catalogue prices or to differentiate among individual customers within a trading group. If a manufacturer publishes a catalogue listing merchandise with constantly changing costs, he may adjust his catalogue prices easily by adding a new discount percentage when costs decrease or by rescinding a previous discount when costs rise. An arbitrary discount is also a convenient way of giving individual customers advantages over other customers within a trading group, a practice which the Robinson-Patman Act seeks to restrict. These arbitrary discounts are accounted for as trade discounts, being either deducted from list price to arrive at the billed price appearing on the invoice or noted as a percentage of list price if the list price is the billed price.

Several of the types of discounts or combinations thereof are illustrated by the following examples.

A wholesale wallpaper company offered dealers on purchases for stock the following terms: 3/30, 2/60, or 1/90, with additional discount within the discounting period for shipment: for shipment in September, 4%; October, 3%; November, 2%; December, 1%; net 91 days. Thus, on a customer's order for $1,000, dated September 1, the customer could elect to pay within 30 days, in which case he would be entitled to a cash discount of $30. If during this same month he accepted shipment, he could receive an additional discount of 4%, or $40, making the net amount due the company $930. If, however, the customer did not wish to pay in September, he might allow the bill to run as long as 60 days, paying it in October, in which case he would be entitled to a cash discount of 2%, or $20, and, if he accepted shipment in October, to an additional discount of 3%, or $30, making the net amount due the company $950. A third possibility was open, namely, payment within 90 days, or during November, in which case the cash discount was 1%, or $10; and if shipment was taken in November, an additional discount of $20 was

earned, making the amount due $970. In any case the bill was due in 91 days. Other combinations of shipping and payment dates were possible.

A manufacturer of shirtings granted the following terms: 2/10, 60 days extra, or 2½/10, 30 days extra, or 3/C.O.D., or 3/10 from date of invoice or shipment whichever is earlier, no extra. On an order for $500, dated September 1, a customer may elect to take the 2%, or $10, on November 10, or the customer may take a discount of $12.50 on October 11. On the C.O.D. order the customer may take a discount of $15, or, finally, the customer may take a discount of $15 on September 11, or 10 days from the date of shipment in case it was made before the invoice date. It may be noted that these terms are practically equivalent when a 6% rate of annual interest is assumed.

A manufacturer of hardware quoted discounts from list of 33⅓%, 10%, 5%, with a 2% cash discount. It should be noted that, when terms are stated in this order, it is the usual practice to deduct each successive discount from the previous balance. For instance, if the invoice showed a list price of $12 a dozen, first the 33⅓%, or $4, would be deducted, leaving a balance of $8, from which 10%, or 80 cents, would be deducted, leaving $7.20, from which 5%, or 36 cents, would be deducted, leaving a net amount due before cash discount of $6.84, from which the 2% cash discount of 14 cents would be deducted, making the net amount due the supplier $6.70.

A scientific instrument company quoted an arbitrary list price from which it granted a discount of 50%, plus 5%. These terms are somewhat unusual. On an item costing $50, first the 50%, or $25, was subtracted to arrive at a net amount, to which 5%, or $1.25, was added to make the price due $26.25.

The Dobson Company (page 509) quoted list prices at $12 a dozen, less 33⅓% to retailers, and 33⅓% and 16⅔% to wholesalers. In this case the retailer paid $8 for the merchandise and the wholesaler subtracted 16⅔% from $8 to arrive at his buying price of $6.67 a dozen.

EXERCISES

Make all the necessary computations in the following exercises. carrying the calculation of all percentages to two places beyond the decimal.

I

1. From the following items determine the gross margin percentage:

Gross Sales	$492,500
Purchases at Net Cost	342,000
Markdowns	60,000
Opening Inventory at Net Cost	118,000
Returns by and Allowances to Customers	37,500
Closing Inventory at Net Cost	137,500
Expenses	125,000

2. A manufacturer quoted a price to a department store buyer of $182.52 a gross for a certain item. If the buyer estimated his expenses of handling the item at 32% of sales, expected no markdowns, and desired a net profit of 3% of sales, at what retail price should he have marked each item?

3. A business concern reported the following: annual stock-turn rate 4 times, gross margin 37%, and average inventory at selling price $75,000. What was the cost of goods sold?

4. In 1940 the house furnishings department of a department store had gross sales of $302,000, customer returns and allowances of $36,500, opening inventory at net cost of $50,225, closing inventory at net cost of $69,070, and purchases at net cost of $190,475. What were the net sales, the cost of goods sold, and the gross margin?

5. Arrange the following items in proper order, and complete the operating statement so far as possible: salaries and wages $31,950, rent $5,100, opening inventory at net cost $29,340, depreciation on fixtures $1,500, returns and allowances $20,508, cash discounts taken on purchases $4,665, inward freight and express $7,030, supplies $3,980, gross sales $208,303, purchases at billed cost $120,900, closing inventory at net cost $26,910, advertising $6,150, and all other expense $6,200.

6. Compute the gross margin percentage, the net profit percentage, and the annual stock-turn rate from the figures in the operating statement drawn up for Exercise 5.

7. At the close of the year 1941, the following items appeared on the books of the Premium Wholesale Specialty Company:

Purchases at Billed Cost	$134,984.75
Inventory at End of Year at Net Cost	33,460.07
Markdowns	5,208.00
Supplies	3,021.95
Net Sales	203,388.56
Cash Discounts on Purchases	3,278.21
Inventory at Beginning of Year at Net Cost	35,369.87
Returns and Allowances	2,236.50
Salaries and Wages	27,579.85
Light, Heat, and Power	4,714.04
Telephone	436.25
Rent	6,785.00
Other Expenses	20,234.07
Advertising Expense	2,634.25
Freight and Truckage on Purchases	754.03

Prepare the operating statement, and compute the percentage gross margin and the annual stock-turn rate.

8. At the beginning of the month of August, the misses' low-price dress department of a department store had in stock 50 summer dresses, which cost $4.75 each. During the month, 20 additional summer dresses at $4.75 each and 40 fall dresses at $6.50 each were purchased. All the summer dresses were marked to sell at $6.95, and all the fall dresses were marked to sell at $10.95. All the summer dresses and 15 of the fall dresses were sold. Customers, however, returned 18 summer dresses and 2 fall dresses. Both the fall dresses were resold for $10.95. The returned summer dresses were marked down to $5.49 and resold at that price. What were the gross sales, the net sales, the gross margin in dollars and percentage, and the percentage of markdowns?

II

1. If the markup on selling price is 38%, what is the markup on cost?

2. If the markup on cost is 65%, what is the markup on selling price?

3. How much may a retailer pay for an article if he wishes to sell it at $1.50 and wants a 36% markup?

4. A retailer sold 25 pairs of shoes at $10, taking markdowns of 8% of net sales in so doing. Originally all the shoes had been purchased at the same price and had been uniformly marked up 55% of cost. What gross margin percentage did the retailer secure on the 25 pairs of shoes?

5. From the following figures compute the stock-turn rate: beginning inventory at cost $12,400, ending inventory at cost $8,500, and cost of goods sold $60,200.

6. From the following figures compute the gross margin percentage: average inventory at selling price $2,500, stock-turn rate 6 times, cost of goods sold $10,000.

7. From the following figures compute the closing inventory at selling price: stock-turn rate 4 times, gross margin 40%, opening inventory at selling price $20,000, and average inventory at cost $15,000.

8. What sales volume is needed to secure a stock-turn rate of 3 times a year on an average inventory at cost of $50,000 and a gross margin of 45%?

9. A men's clothing store purchased the following neckties:

Quantity	Cost (per dozen)	Selling Price (each)
3 dozen	$18.00	$2.50
5 dozen	11.25	1.50
7½ dozen	9.75	1.25

What was the markup percentage at each price? What was the markup in dollars for the entire purchase? What was the markup percentage for the entire purchase?

10. From the following data reconstruct as much of the operating statement as possible:

Gross Sales	$857,711
Cash Discounts Taken on Purchases	24,031
Inward Transportation Charges	25,285
Total Expense	257,792
Beginning Inventory	97,200
Cost of Goods Sold	529,139
Cash Discounts Taken as Percentage of Purchases	5%
Total Expense as Percentage of Net Sales	32%

III

1. The Jameson Radio Company, manufacturer of receiving sets, advertised a retail list price of $299.50 for one of its 1942 models. Under its marketing plan, wholesale distributors were allowed a 15% markup and retailers a 40% markup. At what price did the Jameson Radio Company bill wholesalers? At what price did wholesalers bill retailers?

2. What are the percentages of markup on cost which correspond to the following percentages of markup on selling price: 22%, 30%, 35%, 44%, 55%, 60%?

3. What are the percentages of markup on selling price which correspond to the following percentages of markup on cost: 15%, 40%, 60%, 120%, 200%, 225%, 400%?

4. If a wholesaler with expenses of 12½% marks up an item 20% of cost, what percentage net profit will he secure on an item which costs $1.40?

5. At the close of 1941, the following items appeared on the records of the Brigham Wholesale Shoe Company:

Rent	$ 20,912
Cash Discounts Taken on Purchases	10,224
Gross Sales	982,716
Other Expenses	20,116
Purchases at Billed Cost	780,719
Inventory December 31, 1940, at Market	250,312
Inventory December 31, 1941, at Cost	241,607
Salaries and Wages	72,632
Markdowns	27,700
Freight and Truckage on Purchases	4,608
Freight and Truckage on Sales	5,719
Returns by Customers	3,609
Allowances to Customers	3,120
Supplies	5,012
Cash Discounts Given to Customers	22,618

What were the percentages of gross margin, total expense, and net profit?

6. The Baldwin Dress Company manufactured its \$7.75 line of dresses not only to order but also for stock when it believed that the models would be in demand. During a recent season 8,297 dresses, which cost \$5.89 each, were sold at full price; customers returned 432 of these; 283 of the returned dresses were resold at \$5.50, and 149 were resold at \$3.75. At the end of the season, the company had in stock 354 dresses, which were closed out to a bargain basement buyer for \$1.75 each. What was the gross margin in dollars and in percentage? What was the percentage of markdowns for the line?

7. From the following figures compute the opening inventory at cost:

Annual Stock-turn Rate	3 times
Gross Margin	37%
Closing Inventory at Cost	\$ 7,500
Net Sales	\$60,000

8. A merchant sold 80 suits at \$20 each, taking markdowns of 15% of sales in so doing. Originally all the suits had been purchased at the same price and had been uniformly marked up 66.6% of cost. What percentage gross margin did the merchant secure on the 80 suits?

9. What are the selling prices of the manufacturer, of the wholesaler, and of the retailer when the total manufacturing costs and the markups desired are those indicated below?

	a	*b*	*c*	*d*	*e*
Total Manufacturing Costs	\$0.60	\$7.20	\$67.50	\$0.15	\$0.03
Manufacturer's Markup	42%	35%	33%	67%	17%
Wholesaler's Markup	15%	18%	16.67%	20%	10%
Retailer's Markup	25%	33.33%	40%	33.33%	20%

III

CUSTOMER RELATIONS

1. WOODSTOCK COMPANY

RETAIL SALE OF A CHRISTMAS PRESENT

A young man, obviously of very moderate income, entered the lingerie department of the Woodstock Company, a large department store, late in the afternoon of December 24. He walked the length of the department twice, then came to a halt beside two metal forms on which were displayed three silk slips marked \$2.95, \$3.95, and \$4.95. He touched the \$2.95 garment gingerly just as a salesgirl stepped up to him.

SALESGIRL: Want something?
CUSTOMER: Yes, something like this—a slip, I guess you call it.
SALESGIRL: What size?
CUSTOMER: I don't know, but she weighs 135 pounds, and she is 5 feet 5 inches.
SALESGIRL: Here's one at \$2.95. (She laid a very plain garment in a tea-rose shade, folded, on the counter. The customer fingered it but did not attempt to look at it very carefully.)
CUSTOMER: Haven't you something else—something with more lace on it or something?
SALESGIRL: Here's another with lace at the top and bottom. It's all that's left at the price.
CUSTOMER: I guess it isn't just what I wanted. Thank you.
SALESGIRL: Sorry.

The customer went across the store to the ladies' shoe department. There he walked about until he found a table with bedroom slippers displayed on it; here he stopped but did not touch anything. A salesgirl approached.

SALESGIRL: You're looking for a present; perhaps I can help you. Who is it for?
CUSTOMER: My wife.
SALESGIRL: She likes pretty things, I imagine, doesn't she?
CUSTOMER: Yes, very much.

SALESGIRL: Then here's the prettiest slipper in the store. I know she'd like it. Look, it's covered with baby blue corduroy. Blue is so much newer this season than pink, and corduroy is the nicest possible material, both warm and pretty, and durable, too. The furry blue band across the top keeps her warm as toast and elegant as well. The high tapped heel is popular this year also. A heel is a little thing, but your wife no doubt follows fashions, and she'll like it. And, look, here's the XYZ name inside. You've probably seen their advertisements; but if you haven't, she has. It means the very best that money can buy.

CUSTOMER: How much are they?

SALESGIRL: $4.95.

CUSTOMER: Well . . .

SALESGIRL: Of course that's high. Some of the others you see here, like this felt and that pink satin, are as low as $1.95. And they're nice slippers, too. It's only that they lack just a little the glamorous something that women seem to like.

CUSTOMER: The blue ones are pretty swell, aren't they?

SALESGIRL: Yes, they are. They're about the nicest thing you could get her, I think—that is, if she likes pretty things and if you can afford it. Naturally you always have to consider that. After all, these pink satin at $2.50 are very nice . . .

CUSTOMER: I think I'll take the blue ones.

SALESGIRL: I know she'll love them. What size will be best?

CUSTOMER: She wears a 6½ shoe.

SALESGIRL: Then she'll take a 6½ in these, too. They don't run large as the cheaper things do, and they come in half sizes. Now if you'll wait here just a minute, I'll get these wrapped up in lots of white tissue paper and a white box and red ribbon. Then the outside will look just as lovely as the inside, and you won't have to do a thing but write her name on it.

CUSTOMER: Thanks awfully.

SALESGIRL: Thank *you.*

2. CASCADE DEPARTMENT STORE

DEALING WITH CUSTOMER'S COMPLAINT

Well in advance of the spring season of 1922, the buyer for women's suits in the Cascade Department Store placed orders for 146 tweed suits. It was his judgment that tweed suits would be popular in the spring of 1922, both because of the general fashion movement toward sports clothing and also because tweeds, being of loose-weave construction, could be manufactured to retail at lower prices than many fancy woolen and worsted fabrics. Nevertheless,

he did not wish to order tweed suits heavily before he had tested their popularity with the store's clientele, since the fashion trend had been away from suits during the previous two seasons.

The expense, direct and prorated, in the women's suit department of this store was normally 26% of net sales, and the net profit normally was 4% of net sales. Eighty-one tweed suits, purchased at $25 each, were marked to retail at $48.50; and the other 65 suits in the first order, which were of somewhat less expensive material and cost $20 each, were marked to retail at $35.80. As soon as these suits were placed on sale, it was apparent that tweeds were to be popular. The buyer, therefore, placed orders for 372 suits. By this time other garment manufacturers had copied the designs of the pioneers in the tweed-suit field, and competition had brought the price to department stores down to $17.50 for suits that previously had cost $20. The shopping bureau of the Cascade Department Store reported that competing department stores were selling at $30 tweed suits which were equal in value to those sold by the Cascade Department Store at $35.80. Therefore, as soon as the order was placed for 372 suits at $17.50 each, the retail prices on all tweed suits in the department were reduced to $25.

As the season progressed, sales of tweed suits continued to be large, and more and more manufacturers engaged in the production of this popular style, some of them reproducing it in fabrics of cheaper quality. Replacement prices fell to $15.50, at which figure the suit buyer of the Cascade Department Store, after consulting the merchandise manager, ordered 156 suits. At that time it was becoming difficult to secure deliveries on the dates promised; and several other department stores, which had not bought tweeds early in the season, were reported to be ordering heavily. By the time these suits were received, competitors were selling similar merchandise at from $21 to $23; consequently the Cascade Department Store reduced the price to $19.75. Toward the end of the season it was evident that the popularity of tweeds was to be short-lived. In the Cascade Department Store 76 suits had been sold at $48.50, 64 at $35.80, 295 at $25, and 138 at $19.75. There were left in stock 101 suits. Retail prices on these were reduced to $15 for an advertised clearance sale, and at this price 33 suits were sold. Three days later the price was reduced to $10, at which figure 28 suits were sold There were still left in stock 40 suits which apparently would not move at a retail price of $10 each; consequently, rather than carry

any tweed suits over to the next season, the store reduced the price to $5, and at this figure sold the remaining suits.

During the closing-out sale of tweed suits at $5 each, a regular customer of the store who had purchased a tweed suit early in the season at $48.50 visited the suit department and protested in strong terms that, if the store could afford to sell tweed suits at $5 each, she had been greatly overcharged when she paid $48.50. She also objected to having the suits so reduced in price during a single season that they were bought by numerous persons of lower purchasing power.

Should the store have granted a rebate to the dissatisfied customer?

3. PILGRIM COMPANY

MEETING CUSTOMER'S REQUEST FOR SPECIAL FAVOR

One day in March, 1940, Mr. Alden, the sales manager of the Pilgrim Company, a wholesale grocery concern, had to deal with the request of a large customer that certain staple items delivered by the Pilgrim Company be billed to him at the same price usually paid at the company's cash-and-carry division, the Brewster Company.

The Pilgrim Company, a large wholesale distributor located in Albany, New York, sold all types of groceries to independent grocers within a 30-mile radius of its warehouse. The 1,800 products handled by the company included bulk staples, national-brand staples, and a line of canned goods under the company's private brand name "Standish." The merchandise was sold to retail stores and institutions by 32 company salesmen, who called on each customer at regular intervals varying from one day to two weeks. Orders were turned in daily at the company office in Albany, and the merchandise ordered was drawn from the warehouse and loaded on company trucks for delivery to the customers. The over-all gross margin on goods sold by the service division of the company amounted to 14%; but this figure varied from 2% on competitive items, such as sugar, to over 20% on certain branded specialty items. The total expense of service sales varied from 11.5% to 13% of net sales, depending upon the volume of the period concerned. Of the

total expense, selling expense and receipt and delivery expense each amounted to about 4% of net sales.

In 1925, when the Pilgrim Company had been formed by a merger of several wholesale houses, one of the component firms had operated a cash-and-carry division, which the officers of the Pilgrim Company had decided to continue. They believed at the time that it would be advantageous if customers who complained that prices were too high could be referred to a cash-and-carry unit. The Brewster Company was located several miles from the main warehouse of the company in the Albany wholesale market district, where meats, fish, and produce were sold by hundreds of different firms. The operations of the Brewster Company were under the direction of a manager, Mr. Smith, who had two men to assist him in writing orders and packing the goods for customers. The manager was supervised only in a very general way by the officials of the Pilgrim Company. The latter were of the opinion that because the $150,000 annual business amounted to only 5% of the total sales volume of the company they could not afford to devote a great deal of attention to the division so long as it continued to show a profit.

Mr. Smith was entirely responsible for the buying of all products handled by the cash-and-carry division. The purchases included about 60% staples, such as sugar, evaporated milk, soap, and cereals, most of which were national-brand items, and 40% higher-markup goods, such as canned vegetables, fruits, pickles, and peanut butter, packed under less well-known brand names. The Pilgrim Company officials had decided at the time the division was organized that the Standish brand would not be handled on a cash-and-carry basis. They hesitated to break the prices on this brand for any reason whatsoever, because they believed that, if they did it once, a customer would try to obtain a lower price every time. Aside from the Standish brand, however, Mr. Smith was free to buy whatever he chose wherever he could obtain the best price. Before buying a particular product from manufacturers or packers, he telephoned the buyer at the Pilgrim Company to find out whether he could get the merchandise at lower prices through the company warehouse. When purchases were made on the latter basis, the Pilgrim Company charged the cash-and-carry division the invoice cost of the merchandise plus a 1% handling charge, retaining for itself any cash discount which might have been earned on the purchase. As a result of seeking out the most economical sources, Mr. Smith found

that he purchased about half his supplies from the Pilgrim Company and half from outside suppliers. All purchases were billed through the Pilgrim Company, and the invoices paid from that office.

With the exception of a few telephone orders accepted from old customers, all sales were made in the Brewster Company office to retail grocers who carried the merchandise away with them or left directions for shipment by a public cartage firm. The usual procedure was for the manager to write out on a simple form the order which the customer read from a prepared list. Three copies were made. The original copy was given immediately to the warehouseman who packed the order. The first carbon was the customer's invoice, which in the event of a cash sale was marked "Paid." The second carbon remained in the machine on which the orders were written until the end of the day, when it was removed and sent with copies of all the other orders to the Pilgrim Company office. When the merchandise ordered had been packed by the warehouseman and the customer had taken it away, the warehouse copy of the order was returned to the office. If the sale was a cash sale, the copy was filed away to be held for several months simply as a reference to check any shortage which might be claimed. If the sale was on credit, the name of the customer and the amount of the charge were recorded on an ordinary piece of ledger paper before the copy was filed under the customer's name in the office of the Brewster Company. At the end of the day the ledger sheet was sent to the office of the Pilgrim Company, where the amounts charged were transferred to an accounts receivable ledger. It was the duty of the manager of the cash-and-carry division to follow up all accounts receivable, and he was completely responsible for the collection of any overdue accounts. Only about 30% to 40% of the customers used the 10-day extension of credit which was available. The others paid cash, and the money was deposited each day to the Pilgrim Company's account in the bank.

Mr. Smith estimated that about 150 grocers came to the cash-and-carry division so frequently that he knew their names and considered them regular customers. Not more than 125 came in any one mo th, however. The manager believed that about 30 of the regular customers were grocers with total sales of over $700 a week. The others had sales which probably averaged $300 to $400 a week. Although there were 150 so-called regular customers, about half this number accounted for the bulk of the company's

business, with average purchases of $35 to $40 a week apiece. Most of these customers stopped at the Brewster Company almost every time they came to the market district. Mr. Smith used no outside promotion to increase the number of customers, and he was not interested in expanding his credit business. He did wish to increase the volume of sales of higher-margin goods, however; and he had printed flyers announcing specials which he gave to grocers to distribute to their customers. Because of the absence of selling and delivery expense, the total expense of the cash-and-carry division was very low; in 1939 it amounted to 4.75% of net sales, including 2.75% for salaries and 1% for occupancy. The gross margin for the same period amounted to 5.75%, with a stock-turn rate of approximately once a month.

Among the advantages which Mr. Smith believed his division offered to customers was the speed with which an order could be filled. The warehouseman usually could have the merchandise ready for the customer to take away within 10 minutes of the time the order was received, while some of the company's larger competitors took as long as 45 minutes because of the time required to assemble all the items on an order in a large warehouse. This fact was important because grocers doing their own buying wished to take as little time as possible away from their stores. Another advantage was the assurance of fresh products because of the small stock carried. The fact that each member of the cash-and-carry division knew many of the customers by name, furthermore, probably tended to encourage a more careful handling of orders and a minimum of breakage.

The greatest weakness apparent in the operation of the Brewster Company was the inability to raise the profit margin, because grocers came to the cash-and-carry division for low-margin staples and preferred to buy the high-markup merchandise from companies whose brands were more widely known in the area. The manager estimated that only 10 or 12 customers of the Brewster Company were also regular customers of the Pilgrim Company and that all the rest patronized some other service wholesaler.

Early in March, 1940, John Hancock, one of the Pilgrim customers, had purchased Ivory Soap Flakes at $4.65 a case at the Brewster Company, a price which yielded the company a gross margin of 1.9%. The next time the salesman of the Pilgrim Company called at this store, the grocer said that he would like a case

of Ivory Soap Flakes from the Brewster Company; but since he did not have time to go down for it, he asked that the Pilgrim Company "throw a case on the truck" when the rest of his order was delivered. He expected to pay only $4.65, but the salesman said that the regular price for Ivory Soap Flakes on an order taken by him was $4.80. Mr. Hancock argued that he could buy at the price of $4.65 from another division of the company and therefore could see no reason why he should pay $4.80. He pointed out, also, that he was a large customer of the Pilgrim Company, buying between $400 and $500 worth of goods monthly. The salesman was uncertain whether he should continue to refuse Mr. Hancock's request, and consequently he called Mr. Alden, the sales manager of the Pilgrim Company, on the telephone.

4. KNOX WHOLESALE JEWELRY COMPANY

HANDLING COMPLAINT

Sheboygan, Wis.,
Oct. 20, 1920

Knox Wholesale Jewelry Co.,
Chicago, Ill.
GENTLEMEN:

Please advise us when you will make shipment of watches ordered from you August 25th.

Very truly,
W. J. WILLIAMS & BRO.

October 21, 1920

Messrs. W. J. Williams & Bro.,
Sheboygan, Wis.
GENTLEMEN:

Responding to your favor of the 20th, we find that watch deliveries to us have been taken up entirely by demands from customers who have looked to us for the major portion of their holiday wants all through the line. For this reason we have not been able to divert any of these short grades on your kind order of August 25th. We still keep your wants before us and hope that conditions in the market will enable us to be of better service in this particular short line than we have been to date.

With all kind wishes, we are

Very truly yours,
KNOX WHOLESALE JEWELRY CO.

Oct. 23, 1920

Knox Wholesale Jewelry Co.,
Chicago, Ill.
GENTLEMEN:

In reply to your letter dated October 21st, in regard to watches ordered from you August 25th, this is more or less of an injustice for a firm to take orders with no expectation of making delivery.

We had looked to you for this merchandise and did not try to procure same elsewhere. However, since shipment has been delayed we wish to cancel our order of Aug. 25th.

Very truly,
W. J. WILLIAMS & BRO.

October 25, 1920

Messrs. W. J. Williams & Bro.,
Sheboygan, Wis.
GENTLEMEN:

Responding to your favor of the 23rd, we make haste to advise that on August 25th it seemed probable that your order could be filled, at least in part, before Christmas. We do not want you to believe that our solicitation of your business occurred with no expectation of making delivery of merchandise, orders for which we were lucky enough to receive.

We believe you will agree with us that, when merchandise is so scarce that there are fifty watches wanted to one delivered by the factory, it is only fair to supply these short grades to dealers who, at the same time, ordered the more plentiful merchandise. Our business from year to year is dependent upon several hundred jewelers who look to us for the major part of their merchandise in the lines we carry. If we should disappoint them under present conditions, the foundation of our business would be undermined.

Our letter of the 20th found us with continued expectations of being able to make shipments on the August order. Your cancellation of same is recorded with regret. Should there be any watch numbers upon which prompt delivery would insure a sale, please let us know, giving us as much time leeway as possible and we shall endeavor to be of service.

Very truly yours,
KNOX WHOLESALE JEWELRY CO.

December 27, 1920

Messrs. W. J. Williams & Bro.,
Sheboygan, Wis.
GENTLEMEN:

December 27th is here. Until Christmas day itself we clung to the illusion that we were going to ship you some Elgin wrist watches even though you might return them by next express. It would have

been, at any rate, proof of the warm regard in which we hold your good account.

After our letters of October we were careful to ask Mr. Shelton whether or not you had blood in your eye when he went in to see you He advises that such was not the case but feels that you did not take too kindly to our remarks regarding service to people dependent upon us for general merchandise wants.

Frankly, we can see our mistake. It appeared to you that we were stressing our own interests rather than the general service which we could give to our friends in the trade. If you can, we wish you would forget the previous correspondence and remember that we know service alone is our one excuse for being in business. We have tried to conduct affairs so that loss of sales by customers of ours would fall as lightly as possible over the entire territory. Our receipts of merchandise on your order did not cover one-thirtieth of the demands made upon us by yourself and our other friends in the trade. We are sure you will sympathize with us in our predicament and know you will agree that service goes furthest when directed toward people, many of them much smaller than yourselves, who would have to go out of business on certain lines unless we came to their rescue.

The above is a very poor expression of our regret and possibly no explanation at all of our failure to ship on your August order. We cannot, however, continue at this time of year without a single effort to soften any hard feelings you may have toward us. If you will give us a chance to demonstrate our willingness and ability to ship short grades of merchandise, we will furnish you anything from the first lot which comes to our office.

With this we send every kind wish for a Happy New Year.

Very truly yours,
KNOX WHOLESALE JEWELRY CO.

(No reply was received to the last letter.)

5. DUVAL MACHINE TOOL COMPANY

NEGOTIATIONS WITH RESPECT TO GOVERNMENT CONTRACTS

In June, 1940, the Duval Machine Tool Company was asked by the commanding officer of a government arsenal to quote a price and delivery date on five large automatic machine tools and a large quantity of parts and supplementary equipment. The company's estimator figured that this machinery, at the prices normally received from regular commercial customers, would sell for $145,000 and should be ready for delivery within six months. If this order had been obtained from one of the company's commercial customers, there would have been little hesitancy about quoting this

price and delivery date. Because of certain additional problems involved in handling government business, however, one of the directors questioned the advisability of taking the contract on these terms.

The Duval company was a leading producer of this particular type of machinery. The machines were heavy and complicated, and were manufactured only on order. Because of the highly specialized nature of the operations performed, certain component parts of such equipment required individual engineering; the designing and drafting often took fully as long as actual manufacturing in the plant, and sometimes longer. The Duval company had a large staff of highly skilled engineers and draftsmen trained in this particular kind of work and was therefore one of the relatively few companies in the country which could supply such equipment.

The machine tools produced by the Duval company were used in a wide variety of industries. The automobile industry had in recent years been the largest user of this type of equipment. During 1940, however, the larger part of the company's output was going to meet national defense requirements. Operations were at capacity level, and orders were booked for many months in advance.

The government order under consideration was much larger than those which the company normally handled and, coming at a time of capacity operation, would necessitate sidetracking an equal quantity of regular domestic and foreign business. The company had already decided on a policy of giving complete priority to all government contracts and to all orders for manufacturers working on government business under the national defense program. Individual orders taken by the company usually ranged from $5,000 to $35,000; annual sales volume was approximately $2,000,000. Even though the total order was of unusual size, the machines wanted in the arsenal were of the same basic type as those regularly produced by the company.

On the basis of past experience, it was possible to calculate the cost of the desired machinery within reasonably close limits; it was not, however, possible to estimate with equal accuracy the time when the machinery would be ready for delivery. Designing and drafting appeared to call for about three months' work before manufacturing could begin. The men in the engineering department were already being worked the maximum number of hours possible; and in case progress on the government contract was

slow, there would be no reserve of man power to throw into the job. The chief engineer reported that although the work on this job in the engineering department might require as long as four months, if everything progressed smoothly it might be possible to finish it in a little over two months.

The vice president in charge of production insisted that it would be a serious mistake to try to hold the manufacturing process to a hard-and-fast three months' schedule. If too great pressure were put on for quick delivery and manufacturing delays should be encountered, there would be a temptation to skimp on the final inspections and run-in tests. Painstaking testing would be necessary to uncover possible "bugs" in the new machinery. Sometimes such tests revealed difficulties that required patient redesigning and adjustment. If quick delivery was made without such careful checking, the equipment might cause constant trouble and fail to give satisfactory service.

The company's regular customers understood the reasons for possible delay in the delivery of this type of machinery and did not raise serious objections when promised delivery dates could not be met. The government, on the other hand, had been found very rigid with regard to delivery dates; not infrequently through application of the "liquidated-damages" clause in its contracts the government exacted a penalty for any delay. The liquidated-damages clause in the type of contract under consideration specified that for each day's delay after the specified delivery date 1/10 of 1% should be deducted from the price to be received by the company, this deduction being limited to 25% of the contract price.

The president of the Duval company thought the liquidated-damages clause entirely unnecessary for orders such as the one proposed. If it were possible to complete the contract within four months, the company would be anxious to do so. If the work took longer, the delay would be due to unpredictable and unavoidable difficulties. In the opinion of the president, the liquidated-damages clause was reasonable when applied to standardized products which could be turned out in an easily predictable period of time. In such cases it might reasonably be said that any tardiness was the fault of the manufacturer and that therefore a penalty was justified. Under the circumstances faced by the Duval company, however, the president believed that the liquidated-damages clause was not required as an incentive and might result in unmerited penalties.

A few months previously the Duval company had taken another, somewhat smaller, government contract which also included the liquidated-damages clause. Production had gone according to schedule until a very complicated and expensive machine required in the process had broken down. It had been necessary for the company to obtain a special alloy steel and manufacture new parts for the broken machine before production could continue. This unforeseen complication had delayed delivery on the order for a number of weeks. There had been no other possible way of completing the work earlier. The president had explained the situation to the commanding purchasing officer of the district and asked whether waiver of the liquidated-damages penalty was not justified. The officer had replied that the company obviously could not be blamed for the delay, but that it was not the result of "fire, a strike, or an act of God" and that therefore liquidated damages would have to be deducted according to the terms of the contract. This officer was courteous in his handling of the liquidated-damages question, but at the same time he made it emphatically clear that whenever a provision was included in a government contract that had been signed and accepted, he had no alternative but to see that it was carried out to the letter.

The president understood, however, that in negotiating for the new contract under question the officer in charge of the arsenal had the authority to leave out or add to the standard contract form certain clauses, including that pertaining to liquidated damages, whenever he thought it advisable and necessary to do so.

The Duval company had received only one previous direct government contract of over $10,000 since the passage of the Walsh-Healey Act.[1] The president of another near-by machine tool company stated that his company would not accept a government contract for over $10,000, and that to avoid coming under the Walsh-Healey Act it sometimes split a bid into several parts, each of less than $10,000. In the contract under consideration, some of the individual machines would cost well over $10,000; hence it was impossible to consider a series of smaller contracts exempt from the Walsh-Healey provisions.

[1] This act specified that on any government contract for over $10,000 the work-week must be limited to 40 hours with time-and-a-half pay for overtime. The Secretary of Labor was given authority to designate minimum hourly wages for different industries when production came under the jurisdiction of the Walsh-Healey Act.

The company had experienced one annoying incident as a result of a previous contract coming under the Walsh-Healey Act. Six months after work had been completed, a Department of Labor investigator had suddenly appeared at the office and demanded that all the records pertaining to the particular contract be taken out of the files and that the company proceed to prove that it had complied with the Walsh-Healey provisions in every detail. Office routine was disturbed, and four office employees were kept busy for several days doing nothing except going over the records in the manner prescribed by the investigator. In the opinion of the president, the investigator had seemed more determined to find something wrong than simply to make a reasonable audit to discover whether or not the company had observed the required provisions in good faith. The investigator argued with different executives for the better part of three days about minor proceedings, none of which was finally found to be contrary to the terms of the act. After several more days of going through the detailed records concerning this one relatively small contract, the investigator finally found that two draftsmen had each received $1.53 less than they were entitled to. This small discrepancy had arisen out of the fact that the company had not considered the work of the draftsmen in question as coming under the labor law. A four-page report was prepared on this matter, and the company instructed to pay the draftsmen the additional wages.

The reaction of several of the company's officers to this drawn-out bickering over small details had led them to suggest to the president that the company could spare itself much trouble by not seeking government contracts, particularly when more than enough business was available elsewhere. Were it not for the urgency of national defense, the president admitted that such annoyances might also make him reluctant to deal with government agencies.

At times in the past, the Duval company had run into trouble as a result of rigid adherence by government inspectors to minute aspects of specifications, whether important or not. The president recognized the fact that private companies, or at least those doing a large business with the machine tool industry, had long ago discovered the necessity of a certain degree of flexibility in dealing with one another; they had found that work produced on special order often did not come out precisely in accordance with the minor details of specifications drawn up in advance. Hence, when such

variances in no way affected the serviceability or usefulness of the product, they were generally overlooked. In contrast, some government inspectors had in the past caused the Duval company much delay and unnecessary expense by requiring that work be done over and over until the product conformed exactly to specifications even in minute and insignificant details.

The president reported to the directors that he might be reluctant to take the order in question from certain arsenals because of what he considered to be an unreasonable attitude toward adherence to specifications and an unnecessary insistence on detailed and difficult contractual terms and that he would in such event at least insist on a higher price to offset the additional trouble and expense involved. The personnel of the particular arsenal wanting the machinery, however, had been found in past relations to be keen and alert but at the same time fair and reasonable in their dealings.

For these reasons, the president suggested that the Duval company should waive consideration of any other possible disadvantages involved in this government contract and that if a satisfactory solution to the liquidated-damages question could be worked out, the company should quote the same $145,000 price that would be given to a regular commercial customer. The officer with whom the order was being discussed seemed willing to accept any price asked by the company which was reasonably in line with the customary price of such equipment in the commercial market. He insisted, however, on a specific and early delivery date. Knowing something of the time usually required to obtain such equipment, the officer asked for delivery in four months. The proposed contract first presented to the company included the customary liquidated-damages clause. The president thought it better to seek the elimination of this clause than to attempt to set the price high enough or the delivery date sufficiently far ahead to offset the risk of liquidated damages. He proposed, therefore, that the Duval company quote the $145,000 price to the arsenal with the understanding that the order would be given complete priority in the company's plant and that delivery would be made within less than six months if at all possible.

What action should the board of directors have authorized the president to take?

IV

MERCHANDISING—INFLUENCE OF BUYERS AND CONSUMERS ON MERCHANDISE POLICIES

1. BOWMAN COMPANY

PURCHASE OF RUGS

In November, 1921, the buyer for the rug department of the Bowman Company department store[1] had to decide whether to buy, for delivery in April and May, 1922, a few samples of a new type of rug being manufactured by the Norris Rug Company of Worcester, Massachusetts. This new rug, which was made in the 9- by 12-foot size only, was sold under the name "Belgian Tufted Fabric." It resembled a Wilton[2] rug in quality, but unlike a Wilton rug it was seamless instead of being made in four strips stitched together. The Bowman Company's store was located in Atlanta, Georgia, where the company sold chiefly medium-grade merchandise. The rug department had established a reputation for carrying medium-grade rugs in a wide variety of colors and patterns. The sales

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[1] A *department store* is a large retail store catering characteristically to women, handling a wide variety of merchandise in which women's apparel and home furnishings predominate, organized for purposes of buying and selling into commodity departments but also having a specialized organization for advertising, personnel management, delivery, credit, accounting, and other retail store functions.

In the Census of Business, departmentized stores having annual sales of less than $100,000 are classified as general-merchandise stores. The 1939 Census showed the following number of department stores in the size classifications indicated:

Stores with Sales of	Number of Stores	Sales (000 omitted)
$100,000–$299,999	2,097	$ 373,944
$300,000–$499,999	816	316,345
$500,000–$999,999	571	385,565
$1,000,000 or More	590	2,899,144
Total	4,074	$3,974,998

Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade Analysis by Sales Size* (Washington, Government Printing Office, 1941), pp. 42 and 224.

[2] A common type of rug resembling Brussels carpet, so-called because first made at Wilton, England.

records for the department indicated that $135 was the most popular selling price for 9 by 12 rugs, although the store sold rugs of that size at prices ranging from $75 to $250.

The Norris Rug Company had enlarged its factory to accommodate the large looms required to weave the one-piece rugs. Although it was the first company to produce seamless rugs, it held no patent on the process or the machinery; and other rug manufacturers were free to install the necessary looms if the seamless rugs proved to be popular.

The buyer for the Bowman Company was shown six sample Belgian Tufted Fabric rugs in a variety of colors and designs. The president of the Norris Rug Company was enthusiastic about this new product, and stated that the elimination of seams probably doubled the wearing quality of the rugs. The buyer admitted that practically 75% of the complaints that he had received concerning Wilton rugs during his nine years' experience in rug departments had been to the effect that the rugs showed wear along the seams while the bodies of the rugs still were unworn. The seamless feature added to the attractiveness of the rugs also because there were no seams to mar the smoothness of the surfaces. The president stated that eventually better material could be used in these rugs than in Wilton rugs sold at the same prices, since the expense of sizing and stitching was eliminated by the new process, and since this saving would more than offset the initial expense of installing the necessary new machinery.

The net cost of the 9 by 12 seamless rugs delivered at the Bowman Company's store would be $93.80 each. The normal rate of markup in the rug department was 33% of the selling price. If this rate were applied, the rugs could be priced at $140 each.

Although the seamless feature of the rugs appealed to the buyer, he was not favorably impressed by either the colors or the patterns of the samples shown. The salesman for the Norris Rug Company stated that he had just received an order from one of the largest department stores in the East for 24 seamless rugs made up in the colors and patterns of those samples. When the buyer pointed out that, because of territorial differences in demand, rugs of a color and pattern which sold readily in the East often could not be disposed of except at a sacrifice in Atlanta, the salesman admitted that the assortment of colors and patterns still was limited, but argued that the seamless feature would offset this slight disadvantage.

The buyer, however, thought that his customers were more interested in the colors and designs of rugs than in any other factors.

Before the buyer was willing to place an order for the Belgian Tufted Fabric rugs, he looked at Wilton rugs similar to the ones which had sold satisfactorily in his department during the preceding year. A high-grade Wilton rug comparable to the seamless rugs in quality, and more desirable, in the buyer's estimation, from the standpoint of colors and design, could be bought for $90, to retail for $135 if the usual markup were obtained.

Should the buyer have placed an order for the Belgian Tufted Fabric rugs?

2. BLOOM DRESS COMPANY

MANUFACTURER'S FASHION PROBLEM

In April, 1946, Mr. Bloom, owner of the Bloom Dress Company, was considering the advisability of having one of the styles of spring dresses made up in lighter fabrics for the company's line of summer dresses. Although the dress had attained only a fair volume of sales, Mr. Bloom believed that the style was a good one and that it would gain popularity; he hesitated to act, however, because the same style was being offered by manufacturers of lower-price dresses.

The Bloom Dress Company employed 70 people at its factory in Boston, where it manufactured about 900 dresses a week during 45 to 50 weeks of the year. The dresses were designed to sell in four retail price lines: $14.95, $16.95, $19.95, and $22.95. The corresponding wholesale prices were established at $8.75, $10.75, $11.75, and $12.75 so as to yield the retail store a normal markup. In negotiating with dress manufacturers, department store buyers were likely to accept the established price lines, although they might demand concessions in the form of cash discounts. Their principal concern was with matters of fashion, quality, workmanship, and service.

Although fashion was the most important factor in the sale of dresses, the Bloom company did not find it necessary to offer new

models so frequently as certain other dress manufacturers, because it made dresses only in women's sizes. New styles were nearly always introduced in misses' sizes first, and only after a period of trial were they adapted for manufacture in women's sizes. While the Bloom company attempted to keep up to date in the matter of fashion, it did not add a new dress to its line unless it was reasonably sure of a fair volume of sales. Some of the designs which the company used were originated by the designer retained at the factory, whose principal method was to make minor variations in models already in the line. Most of the completely new models were obtained from an independent designer in New York, who was paid $50 for every one which the company accepted, regardless of the number of dresses made from the design. Some of the models submitted by this designer were original, and some were copied from dresses displayed by other manufacturers.[1] The New York designer obtained ideas for new models also from the showings of certain firms which specialized in importing dresses from Paris and permitting them to be copied in return for a fixed fee.

When a model was received at the Bloom factory, it was turned over to a pattern maker. His pattern, when completed, was laid out on yellow paper the same width as the cloth from which the dress was to be cut. Since the manner in which the pattern was laid out determined the quantity of cloth which would have to be wasted in the cutting, this step required a considerable degree of skill from the

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[1] Since fashion may be briefly defined as the acceptance of style, fashion developments inevitably involve modifying and copying. Evils have long been alleged to exist in the copying of designs, and legal means of preventing "design piracy" have been sought for many years. Specific legislation covering these matters has thus far failed of enactment.

Numerous manufacturers of higher-price dresses, banded together in the Fashion Originators' Guild, sought during the 1930's to protect themselves from design piracy by requiring their department store customers not to handle models proved to be copied from designs registered with the Guild, on pain of refusal to deal with the offending stores. Some department stores objected to the requirements established by the Fashion Originators' Guild and sought judicial relief. Consequent litigation resulted in a decree in favor of the Fashion Originators' Guild. At about the same time, however, the Federal Trade Commission instituted proceedings against the Fashion Originators' Guild as a monopoly in restraint of trade and issued a cease and desist order against its practices. This cease and desist order was finally upheld by the Supreme Court of the United States. (*Fashion Originators' Guild of America, Inc., et al., v. Federal Trade Commission.* March 3, 1941. 312 U.S. 457.)

Subsequently members of the Fashion Originators' Guild sought to obtain some design protection by means of patents; but this procedure was cumbersome and not generally considered satisfactory.

"marker." The actual cutting was done with an electric knife which cut at one time enough pieces for an entire pattern run, ordinarily at least 25. Subsequently the pieces went through the hands of operators, drapers, finishers, and pressers.

The dress which Mr. Bloom was considering for the company line as a summer dress had a 24-gore skirt, a V neck with a lingerie collar, a bunch of violets, short sleeves, and tucking at the waist. The model had been obtained from the New York designer in January, 1940, and sold to retail at $19.95. It was very successful in the beginning, with sales of about 200 units a week; and it was copied almost immediately by a manufacturer whose dresses retailed at $12.95. The Bloom company continued to obtain reorders; but sales gradually declined, and by April the company was selling only about 25 of the dresses a week. If the dress were reintroduced as a summer dress, the company would not have the expense of a new model. Mr. Bloom did not wish to introduce it, however, unless he could sell at least 100 dresses, partly because of the expense involved in cutting a new model and partly because he believed that the company's reputation suffered when there were slow-selling dresses in the line.

In spite of Mr. Bloom's belief that the model would be popular as a summer dress, his experience with two of the company's customers in January caused him to hesitate. Soon after the lower-price dresses in the same model appeared, a St. Louis department store had asked the Bloom company to grant it an allowance on the dresses of this model which it had in stock, in order that they might be marked down to $12.95 and closed out. Yet during the same week another department store in St. Louis had sent in a reorder for the dress to retail at $19.95.

Mr. Bloom had little confidence in the theory that fashions always started in high-price dresses and gradually worked down the line until they finally reached the lower price ranges. He knew, for example, that his firm occasionally copied $79 dresses and offered them for sale at $14.95. He had been told that one of the low-price chains, whose dresses retailed for $7.95, regularly "shopped" the upper Fifth Avenue stores and often reproduced new models as soon as they appeared in these stores. The time required to accomplish this was almost negligible; in fact, an adept manufacturer could have a model ready for display to buyers within 4 to 6 hours after it appeared in the window of a high-grade store.

Another indication of the inconsistency of the movement of fashion was the use of the Fashion Importing Service. In February, 1938, for example, the leading style importer had displayed a full flared skirt with a wide waistband which she had obtained in London. Within a few days after the first showing, dresses embodying this type of skirt were being sold at eight to ten different prices ranging from $7.95 to $200. During February and March, the style gained a rather limited acceptance; but at the April showings in Paris, almost all the leading designers showed a somewhat similar skirt, and it was soon offered in volume by stores of almost all price ranges.

Mr. Bloom also had little confidence in the theory that fashion acceptance moved in a regular geographic pattern from Paris to New York and from there to other sections of the country. He pointed out that one very popular dress in the Bloom company's line had been designed originally by a St. Louis dressmaker early in 1936. It was called the "stud dress" because the buttons for the blouse were similar to the studs for a man's shirt. A small bow and special treatment of the collar, shoulders, and pockets were the other distinctive features. Initially the dress was offered to a St. Louis department store, and a few were sold; the designer then took it to Marshall Field & Company in Chicago, where it was promoted and sold at the rate of 100 a day at $19.95. Shortly thereafter a New York manufacturer copied it and offered it early in the spring of 1936 to retail at $5.95. The Bloom Dress Company adopted the model in July, 1936, to retail at $14.95 and after selling a few units discontinued it. Unexpectedly, however, the reorders on the dress proved to be large. Consequently the model was reintroduced in the fall of 1936 to retail at $14.95, and the Bloom company sold as many as 300 a week for several months. Early in 1938 this dress was discontinued. In the fall of 1939, however, the Bloom company again placed the same style in its line, although changing the skirt to conform to the shorter dresses then in fashion. During the winter of 1939, the company sold 150 dresses a week in that style to retail at $14.95. At the same time, the original dress of the St. Louis designer was still being sold at $19.95 in numerous stores.

How should Mr. Bloom have reasoned in deciding whether to reintroduce the spring dress in the lighter fabric as one of the company's line of summer dresses?

APPENDIX

SOME NOTES ON FASHION[1]

I

Matters of style and fashion change are complex and but little understood. These notes present some of the definitions and theories which have been formulated, but they manifestly fail to explain many of the observed phenomena. By and large, merchandising executives, both in manufacturing and in retail establishments, still operate largely on a "hunch" basis in dealing with fashion problems.

Paul H. Nystrom defines *style* as "a characteristic or distinctive mode or method of expression, presentation or conception in the field of art."[2] Thus a style is a more or less permanent rather than a temporary phenomenon. It may or may not be a fashion at any given time. When a style is generally accepted and used by the people, it becomes a fashion. Thus Queen Anne is a style of furniture today just as it was in 1715. Now, however, it does not happen to be the fashion because it is no longer in general everyday use. As Dr. Nystrom points out, "A fashion is always based on some particular style. But not every style is a fashion. A fashion is a fact of social psychology. . . . A style does not become a fashion until it gains some popular use, and it remains a fashion only so long as it is so accepted."[3]

A fad, as Dr. Nystrom defines it, is "a miniature fashion, usually running for a shorter time and usually applying to some unimportant matter or detail in style of apparel, home furnishings, or other articles of use in which the quality of art is present and important."[4] A fad is usually based on novelty and is ordinarily of comparatively short duration.

Paris, Hollywood, the stylist, the manufacturer, the retailer—each of these has been called the cause of fashion change. Actually all that any one of them can do is create or offer for sale certain styles. None of them can be said to create fasion. Only consumer acceptance can

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[1] These comments were prepared at the time when Paris still occupied a dominant position in the world of women's fashions. Following the fall of Paris in 1940, much of this dominance was lost; but no other city was immediately able to assert unquestioned leadership in the design of women's apparel. In subsequent months, the work of American designers, centered largely in two locations, New York and Hollywood, achieved more and more prominence. American designers whose creative efforts have received recognition include, among others, Adrian, Louella Ballerino, Tom Brigance, Irene M. Bury, Clarepotter, Helen Cookman, Louise Barnes Gallagher, Howard Greer, Elizabeth Hawes, Muriel King, Kiviette, Irene Lentz, Philip Mangone, Sally Milgrim, Germaine Monteil, Maurice Rentner, Nettie Rosenstein, Herman Patrick Tappe, Jessie Franklin Turner, and Valentina.

Up to the end of 1941, it seemed reasonably clear that although the vicissitudes of war had, temporarily at least, dislodged Paris from its position of primacy in the design of women's apparel, no fundamental change ascribable to the war had as yet taken place in the mechanisms of fashion behavior.

[2] *Economics of Fashion* (New York, Ronald, 1928), p. 3.

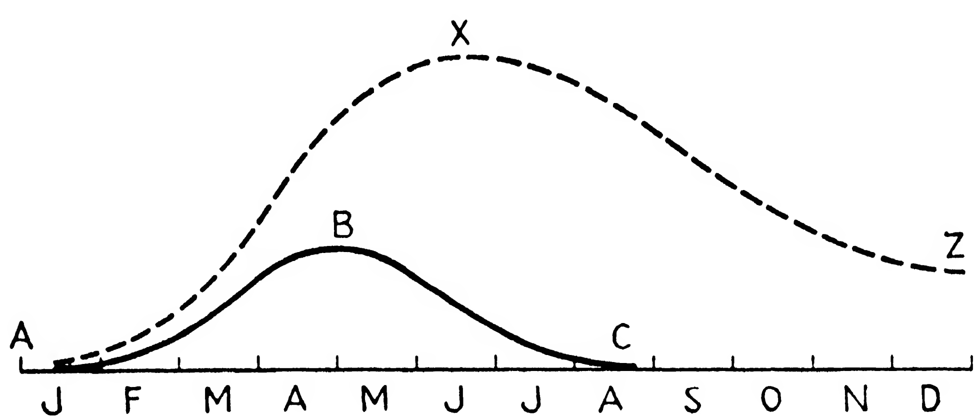
[3] *Fashion Merchandising* (New York, Ronald, 1928), p. 33.

[4] *Ibid.*, p. 34.

make any style into a fashion. Since fashion depends on consumer acceptance of an idea and since people do not react simultaneously or identically to an idea, fashion change is evolutionary. Fashions are orderly growths which rise from imitation. Thus any fashion has its beginning when only a few people are influenced by it, its culmination when the masses follow it, and its decline when it is gradually abandoned by more and more of its followers.

Of this so-called fashion cycle Dr. Nystrom says: "By this term is meant the rise, culmination and decline of popular acceptance of a style. The popular use of the term unfortunately may be both confusing and misleading. Cycle literally means circle and as applied to fashion suggests starting with some style, moving away from it and finally coming back to the same style again. Nothing like this is meant by the term 'fashion cycle' here. . . . The fashion cycle is simply the forward wavelike movement completed and involves no necessary repetition of the style."[1]

Most commonly the fashion cycle is represented by a simple curve *ABC* (as shown below), on which *A* is the point of inception, *B* the point of greatest popularity, and *C* the point of abandonment. On the horizontal axis are measured time intervals; on the vertical axis, the number of people purchasing or using the style.



If *ABC* represents consumer purchase of a fashion, consumer use will follow a different curve, *AXZ*. This point is of importance, particularly to the buyer of fashion merchandise. When the fashion is in greatest use (*X*), consumer buying has already declined and store stocks are being cleared rather than replenished.

A fashion commonly tends to follow a regular curve from inception to popularity and so to decline. Various theories regarding this regular movement of fashion have been formulated with reference to the manufacturer, to consumer types and buying motives, to geographical location, and to types of stores and store policy. Exhibit 1 presents some of the more important of these theories in compact form.

A theory of fashion in manufacturing has been formulated by Paul T. Cherington.[2] According to this theory, in the period of incep-

[1] *Economics of Fashion*, p. 18.
[2] "Some Commercial Aspects of Styles and Fashions in the Clothing and Textile Industries," *Harvard Business Review*, Vol. II, No. 4, July, 1924.

tion of a fashion, the manufacturer concentrates on creation or initiation of a style and its adaptation to general use. As the fashion progresses toward popularity, it is imitated by other manufacturers and produced on a somewhat larger scale. Before the peak of popularity is reached, mass production begins. Just before decline of the fashion sets in, its manufacture is abandoned.

EXHIBIT I
SOME THEORIES OF FASHION MOVEMENT

Fashion Stage	Manufacturer (Cherington)	Consumer Types (Alcott)	Consumer Motives (Copeland)	Geographical	Type of Store (Copeland)	Store Policy (Creighton)
1. Inception	1. Creation	1. Style Leaders	1. Desire for Distinctiveness	1. Paris. Hollywood. Fifth Avenue	1. Specialty Shop (High-grade)	1. Style Alertness
	2. Adaptation	2. Runners-up		2. New York and Other Big Cities		
2. Popularity	3. Popularization (Imitation. Reproduction)	3. White Collar Masses	2. Emulation	3. Big City Department Stores. Small Town Specialty Stores	2. Specialty Shop (Medium-grade) and Department Store (High-grade)	2. Mass Merchandising of Complete Stocks of Style in Vogue
	4. Mass Production					
3. Decline	5. Decline	4. Necessity Group	3. Economical Emulation	4. City Basements. Small Town Department Stores and Rural Districts	3. Department Store (Low-grade)	3. Special Sales Promotion
	6. Abandonment	5. Subsistence Group				4. Clearance—Close-out

John E. Alcott, in lecturing on Art in Industry, has represented the movement of fashion by a five-rung ladder. The top rung he calls "high style" and suggests that at this point the fashion is adopted only by style leaders. On the second rung, first imitators, or runners-up of the style leaders, begin to purchase. On the other rungs, the white collar masses, the necessity group, and finally the subsistence group gradually adopt the style. Since people tend to imitate their leaders, fashion always moves down this ladder, never up.

Melvin T. Copeland's theories of fashion movement, somewhat more widely known, proceed along similar lines.[1] Interpreting fashion in terms of the consumer and his buying motives, Dr. Copeland asserts that fashion begins among style leaders of high income, who buy through a desire to be distinctive in what they wear, use, or do. "The buying motive of distinctiveness," he declares, "arises from a desire to manifest individuality in judgment or taste, or to display leadership in personal appearance." It is the motive underlying a woman's purchase of a Paris gown—the desire to be different and to be first. "A retail merchant," Dr. Copeland continues, "with a store on Fifth Avenue or Michigan Boulevard, who arranges his window displays with 'exclusive' artistic taste and without display of price tags, consistently caters to the buying motive of distinctiveness. He shuns price comparisons and avoids suggestion of emulation." This retailer operates a high-grade specialty shop[2] either as a unit store or as a specialty department in a department store and advertises his merchandise as "distinctive" and "out of the ordinary."

If the style gains popularity, Dr. Copeland maintains, the so-called white collar masses adopt it through the emulation motive. This increased demand brings the style within the scope of the high-grade department store and of the specialty shop which reaches out for a large volume of sales.[3] The consumer who purchases through the emulation motive is anxious to equal or rival her associates in display. She wants to "keep up with the Joneses." She does not wish to be behind the fashion in her particular social group; yet she does not have the initiative, judgment, and social influence which might lead her to attempt to set a new fashion. She responds to advertising which stresses such things as "silk, the accepted fabric of elegance," "the modern woman's favorite car," or "the soap all discriminating women ask for."

As the style gains still wider acceptance, it is properly carried by lower-grade department stores, where lower income groups purchase it at the prices made possible by mass production. The motive of these groups Dr. Copeland terms "economical emulation." He says, "The appeal to emulation ordinarily does not stress cost or economy. At first thought, furthermore, cheapness seems inconsistent with emulation, for the latter frequently operates to prove, at least nominally, that the consumer can afford to 'keep up' with her acquaintances, that she does not find it necessary to economize more than they do. . . ."[4] As a style becomes successful, however, it is produced in cheaper materials in large quantities and sold at low prices. At this point, according to Dr. Copeland, the motive of economical emulation enters. The motive of economical emulation is characteristic of the late stages of the style cycle and in fact accelerates the rate of style obsolescence. Once a style

[1] *Principles of Merchandising* (New York, McGraw-Hill, 1924), pp. 163–167.
[2] *Ibid.*, pp. 71, 104.
[3] *Ibid.*, p. 88.
[4] *Ibid.*, p. 166.

is sold at very low prices and in large quantities, it no longer appeals to consumers impelled by the motive of distinctiveness.

In summarizing his theory of buying motives, Dr. Copeland declares, "Distinctiveness, emulation, and economical emulation mark three distinct stages in the style cycle. A manufacturer or merchant . . . finds it advantageous to decide in which stage of the style cycle he will operate and then to coordinate his merchandising plans accordingly. The determination of the grade of goods to be offered, the selection of the buying motive to which to appeal, and the choice of the type of customers at which to aim are interdependent decisions from the merchandising standpoint."[1]

Another view, in several respects different from Dr. Copeland's theory, outlines buying motives and behavior with reference to fashion change as follows:

MOTIVE	BEHAVIOR
Desire for change Desire for distinctiveness Desire for notoriety	Innovation
Desire for social approbation	Imitation
Desire to go with the crowd	Conformity
Fear of being conspicuous	Acquiescence

In contrast to Dr. Copeland's somewhat aristocratic theory of fashion, this view maintains that a vogue may be initiated by chorus girls, motion picture stars, or shop girls, as well as by the socially elite. Innovation requires adequate purchasing power and a desire for distinctiveness, change, or notoriety; it requires also a sort of social daring. Wherever these are present—in whatever social, cultural, or income group—leaders of the fashion procession may be found. Once the fashion parade has started and the leaders are well in front, a number of spectators promptly fall into line. Thus through desire for social approbation these people imitate styles which they were not courageous enough to introduce. So impetus is added to the fashion movement. When adoption of the style has become fairly general—when the procession has achieved substantial proportions—desire to "go with the crowd" impels the great mass of consumers to conform. Still, however, there are a few ultraconservatives reluctant to adopt anything new, loath to change their accustomed habits in any detail. Eventually they acquiesce in the new style, but only to avoid being conspicuous.

The spread of fashion acceptance from one community to another and from one social group to another within a community is described by Dr. Nystrom in his *Economics of Fashion* (page 36). Fashion, particularly in apparel, he says, commonly begins in Paris, in Hollywood, or on Fifth Avenue. As the movement gains force, the style becomes fashionable in New York and other big cities, first in specialty and then in department stores. Some time later, it appears in small-town stores and in rural districts. Although modern means of

[1] *Ibid.*, p. 167.

transportation, the radio, the popularity of motion pictures, the wide circulation of newspapers and periodicals have clearly lessened the so-called geographical lag in fashion, there is still a tendency for fashion to move from big cities to small, from East to West, and from resorts to industrial communities. According to Dr. Nystrom, the sweep of fashion across the country is now very rapid; the spread of a fashion within a community, however, from those who are the first to take it up to those who are the last to adopt it, while more rapid today than in the past, is still comparatively slow. Cities and localities differ from one another, of course, so that fashions do not always spread throughout the country; and if they are countrywide, they do not necessarily spread at the same speed. A fashion readily accepted in New York might not achieve the same acceptance simultaneously in other cities.

A theory of store policy with respect to fashion merchandise is enunciated by Gordon K. Creighton. It is his view that the merchandising operations of a store fall into four distinct phases, as follows:

"1. The style-alertness phase: This phase is predominant during the style inception period of early season, but it is never completely absent. This phase also includes the merchandising of high-taste merchandise at all times and in all income classes to which the store addresses its appeal. The keynotes of this phase are individuality, taste, new and significant styles.

"2. The fashion-completeness phase: This is the period of mass merchandising of complete stocks of the styles which have proved acceptable to the public and which have become the fashions. The keynote appeal of this phase is completeness of stock on the wanted things, the fashions.

"3. Special-sales phase: This phase covers the merchandising of special promotional purchases and sales on the basis of primary market opportunities. The keynote of this phase is value-price.

"4. Close-outs and clearances of all remainders: The keynote of this phase is also value-price, but with selections more restricted and values more sharply accentuated."[1]

As the season proceeds, Mr. Creighton points out, there is a progressive shift in emphasis from one to another of these phases. For stores of different types, however, relative emphasis on the four phases will, of course, vary.

Many styles never progress beyond the first, or inception, stage. They appear in specialty shop windows but, failing to gain wider popularity, die quickly away. Once they have progressed to the popularity stage, however, fashions may be expected to take their normal course through the cycle.

Fashions may be of either long or short duration. Usually they tend to develop more slowly and to persist longer in durable than in

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[1] Excerpt from address before Sales Promotion Division and Merchandise Managers' Group of the N.R.D.G.A., reported in *Women's Wear Daily*, February 6, 1929. Reprinted by permission.

nondurable goods. It is undoubtedly true that the increased tempo of modern living has tended to speed up the movement of fashions, so that, even in durable goods, modes succeed one another more quickly than they did. New technical devices accelerating mass production and facilitating effective and cheap reproduction of styles likewise have made the progress of styles from the inception stage to extinction much more rapid. Other contemporary phenomena, such as increased purchasing power, increased leisure, ease of communication, effective sales promotion, and a generally progressive spirit, may speed a particular fashion in its course.[1] In the same way, human customs, habits, and dislike of change, as well as religious or social forces, may retard the speed of a fashion movement.

Just as each fashion goes through a regular period of development, so each series of fashions probably tends to follow a regular curve. Fashions are not isolated movements which have abrupt beginnings and endings, because people are creatures of habit and custom, and new ideas are not readily accepted unless they are related to something to which people are already accustomed. Each fashion, therefore, grows out of preceding fashions and merges into those which succeed.

Styles usually catch the popular imagination only if they are directly in line with some trend, with some current fact, or with some line of thinking already established. Although retailers and stylists can guide and influence the character and direction of fashion movements, they cannot create them. The successful fashion seems to be that one which is in line with current trends of living and thinking. Outstanding current events, dominating ideals, and dominating social groups often form a base from which fashions may be originated.

But as indicated at the outset, theories about fashion change have not yet developed to a point where they provide a satisfactory basis for management principles. Indeed there is doubt in many quarters whether fashion follows any predictable pattern. In her book *Fashion Is Spinach*[2] Elizabeth Hawes goes to the extreme of condemning fashion entirely:

" . . . I've become convinced that ninety-five per cent of the business of fashion is a useless waste of time and energy as far as the public is concerned. It serves only to ball up the ready-made customers and make their lives miserable. The only useful purpose that changes in fashion can possibly have is to give a little additional gaiety to life. But by the time you've taken off fashion's bright cellophane wrapper, you usually find not only that fashion is no fun at all, but that even the utility of your purchase has been sacrificed.

"Fashion is so shrouded in mystery, so far away and so foreign, so complicated, and so boring when you understand its ways, that it has become a complete anachronism in modern life. One good laugh, and the deformed thief would vanish into the past."

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[1] See Nystrom, *Economics of Fashion*, pp. 24–29.

[2] New York, Random House, Inc., 1938.

On the assumption, however, that theories of fashion can be made to serve management, the following questions are still among those which remain to be answered:

1. Is there any basis of forecasting what particular styles are likely to become fashions; in other words, is the vogue of any particular style purely accidental, or is it possible that observation of fashion phenomena will ultimately give a basis for forecasting which of two styles is more likely to become a fashion?

2. Is the social stratification theory of fashion movement sound, with its implication of definite zones of activity for various grades of stores; or is this an oversimplification of the facts? From a practical aspect, what are the indices which a manufacturer or distributor should watch in determining what fashions to offer and what fashions to discontinue?

3. Is the geographical spread of fashion more rapid than the spread among groups in the community? Has the reduction in geographical lag been sufficient to permit synchronized mass merchandising of fashion goods?

4. Is there a speeding up of the movement of fashions from group to group in a community comparable to the reduction in the geographical lag?

5. Is the speed with which a fashion declines related to the speed with which it was adopted, or does this depend on other factors?

II

On April 8, 1942, the WPB issued General Limitation Order L-85, imposing certain restrictions on the design of feminine apparel. Part of the text of this order was as follows:

(e) *General Restrictions* on the Manufacture and Sale of All Articles of Feminine Apparel. Except as otherwise herein expressly provided, no person shall, after the effective date of this Order with respect to such person, put into process any cloth for the manufacture of, or sell or deliver any feminine apparel with:

(1) more than two articles of apparel at one unit price, except when specific restriction herein has limited the sale of any article of apparel to one unit at one unit price.

(2) any garment of multiple units, any of which contain wool cloth to be sold at a unit price, if they were not in jobbers or retailers stock at the time this Order became effective on the manufacture of such garments made of wool cloth.

(3) French cuffs on sleeves.

(4) double material yokes.

(5) balloon, dolman, or leg-of-mutton sleeves.

(6) fabrics which have been reduced from normal width or length by allover tucking, shirring, or pleating, except for minor trimmings.

(7) inside pockets of wool cloth.

(8) patch pockets of wool cloth on a lined wool cloth garment.
(9) interlinings containing any virgin or reprocessed wool.

. . . .

(*g*) *Curtailment* on Women's, Misses' and Junior Misses' Daytime and Evening Dresses. No person shall, after the effective date of this Order with respect to such person, put into process or cause to be put into process by others for his account, any cloth for the manufacture of, and no person shall sell, any:

(1) *Daytime Dresses*, as follows:

(i) with a separate jacket, redingote, coat, cape, or bolero to be sold with a one or two piece dress at one unit price.
(ii) with a separate or simulated jacket or top that is longer than 25 inches from the nape of the neck to the end of the finished jacket for size 16; other sizes varying in accordance with schedule B attached hereto.
(iii) with a separate or attached hood, shawl, cape or scarf.
(iv) exceeding 43 inches in length for size 16; other sizes in accordance with schedule C attached hereto.
(v) with a lining known as a bodice attached to skirt of a two piece dress.
(vi) with a petticoat, overskirt or apron.
(vii) with more than 78 inches of material other than wool cloth at its maximum width or sweep, exclusive of seams, for size 16; other sizes in accordance with schedule C attached hereto.
(viii) with more than 72 inches of wool cloth weighing 9 oz. or less at its maximum width or sweep, exclusive of seams, for size 16; other sizes in accordance with schedule C attached hereto.
(ix) made of wool cloth weighing more than 9 oz. per yard, containing at its maximum width or sweep more than 64 inches of cloth, exclusive of seams, for size 16; other sizes in accordance with schedule E attached hereto.
(x) with a separate or attached belt or sash exceeding 2 inches in width.
(xi) with a three-quarter or full-length sleeve exceeding 14 inches in circumference at the bottom of the finished sleeve, for size 16; other sizes varying in accordance with schedule C attached hereto.

In commenting on the effect which this order would have on developments in fashion, H. Stanley Marcus, Chief of the Apparel Section of the WPB, wrote in part as follows:[1]

[1] *Women's Wear Daily*, April 8, 1942.

Can Fashion Survive Order L-85?

"YES, is the emphatic answer to that frequently asked question.

"Fashion is with us and will be with us always. The flame of fashion can't be quenched like that of a burning building. The force of fashion can't be subdued like that of a wild animal. Fashion will adapt itself to the order of the day, just as it always has in the past. The order of this day is conservation, and fashion will cut its pattern to meet the existing and future supplies of cloth.

NEW IDEAS MAY TRANSFORM FASHION

"The limitations contained in this order obviously restrict the designers in dimensions, but there is no reason to believe that new ideas won't transform those very limitations into a new expression of fashion. There have been great periods of fashion when great yardages were consumed, and there have been equally great periods when small yardages were used. Fashion blossomed during both eras.

SOLELY FOR CONSERVING FABRICS

"This order was created solely for the purpose of conserving fabrics of all fibers in order to avoid possible shortages of finished garments. While the potential saving per garment may be little, yet a little multiplied by hundreds of millions of garments means a lot of yards of fabrics. By conserving yardage in individual garments, consumer, manufacturer, worker and retailer, are assured of a more normal supply of garments.

OPPORTUNITY TO COOPERATE

"Through this order, the Government is giving the industries an opportunity for cooperating in the fabric conservation without basic changes in the character of their product and their operations. It is not possible at this time to discuss the length of the period to be covered by these rules. New restrictions may be dictated by more acute stringencies in the fabric supply situation or by the failure of these measures to achieve their aim.

NO NEEDLESS DISRUPTION

"Without compromising with our necessary objective of reducing the volume of textiles consumed for women's and children's garments, we have sought to avoid needless disruption of the production and distribution operations of these trades. We have, for example, given appropriate recognition to the fact that regulations that would require radical revisions in the types and styles of clothes worn by American consumers by rendering obsolete the garments in the consumer's wardrobe might cause great economic wastage by destroying the market for goods previously produced and that which is now available in the stores.

"The fabric-saving rules do not regiment clothes. The nonfunctional features being eliminated do not narrow the scope of a manufacturer's fashion ingenuity. No attempt is being made to design by edict. We are, however, hopeful that the members of these industries will make textile conservation a major theme in their creative efforts in order to effect economies beyond those contained in the order itself."

3. ROCKWELL COMPANY

GRADE LABELING FOR CANNED GOODS

In the fall of 1934 the management of the Rockwell Company, a large packer of high-quality canned goods of all types, was disturbed over the possibility that Congress might enact legislation requiring the standardized grading of canned goods or might include in the Canning Code under the National Industrial Recovery Act a provision requiring such grading.[1] Certain governmental authorities had urged that standardized vertical quality grades be shown on all canned goods. Several of these grades, known as the A, B, C, and D grades, had already been formulated by the U.S. Bureau of Agricultural Economics, and it was proposed that every canner be required to state on his label to which one of these grades his product belonged.

The Rockwell Company sold most of its canned goods under the "Rockwell" brand, but it packed some merchandise under the private brands of distributors and chain stores. Printed on the labels of the cans sold under the company's own brand was information describing the contents of those cans. The company took care to differentiate the common varieties of canned goods from those less well established in the public's mind. White corn, for instance, was for many years the only variety of canned corn sold and was generally accepted as the common variety; hence the company had not printed on its labels the fact that the corn was white. Yellow corn, on the other hand, had been packed for so few years that the company differentiated this corn from the other by the color of the ears of corn pictured on the label and, in addition, by a statement on the label that the can contained golden bantam corn. Similarly, for many years the

[1] For additional material see J. Philip Wernette, "Grade Labeling versus Descriptive Labeling," *The National Marketing Review*, Vol. I, No. 2, 1935, pp. 131–140.

only kind of corn canned off the cob was known as "cream style," which consisted of split kernels packed in a creamy liquid. The kernels were cut from the ear at 50% or 75% of their depth, and the remaining part of the kernel scraped from the ear. Labels on cans containing this type of corn made no mention of the style of pack, but cans containing the newer "whole-kernel" type carried a statement of that fact on the label.

Officials of the Rockwell Company stated that they were opposed to the suggested system of grading because they considered it unworkable and also unfair to the packers and canners. They stated that a committee of the National Canners Association, of which the Rockwell Company was a member, had formulated the principal objections to the plan, as follows:

1. A quality grade if it includes the factor of flavor is an intangible characteristic not susceptible of physical or other objective tests.
2. A quality grade if it excludes flavor or any other intangible characteristic in order to make the grade enforceable is not only misleading but positively deceptive to the consumer.
3. A combination of descriptive labeling and quality grades is but little less deceptive to the consumer because use of the quality grade implies that it represents factors not specifically covered by the descriptive terms when, as a matter of fact, an enforceable quality grade must exclude the intangible factors not covered by the descriptive terms.

The report of the committee continued:[1]

But even were these difficulties removed, your committee believes that any system of collective grades would still work out to the ultimate disadvantage of the consumer—and the grower—by bringing about a general lowering of the quality of canned foods.

The trade recognizes and deals in many more than four grades, while a considerable part of the entire production of canned foods is packed to intermediate grades. This is possible, first, because dealings within the trade are between experts, each of whom is capable of appraising for himself the claims of the other, with the result that general legal enforceability is seldom involved because where necessary the parties resort to arbitration; second, these intermediate grades exist because of the present opportunity to secure a premium on the basis of expert subjective appraisal for intermediate qualities.

If, however, the public is taught to buy on the basis of grades, then the packer of intermediate grades will be forced by competition to

[1] National Canners Association, *Final Report of the Committee on Labeling*, September 26, 1934, p. 4.

lower the quality of his pack to the minimum requirements of the grade. Theoretically, he might raise it to meet the requirements of the next higher grade, but unfortunately for the industry as a whole there is no such option since nature supplies far more raw fruits and vegetables of the lower than the higher grades.

To indicate the difficulties involved in the formulation of vertical quality grades for canned goods, an official of the Rockwell Company listed the number of different factors which affected the edibility of canned corn as follows:

1. Style of pack
   a. Cream style: kernels cut from the ear to 50% or 75% of their depth, and the balance scraped from the ear
   b. Whole kernel: kernels removed intact from the ear
   c. Corn on the cob
2. Tenderness: very tender, fairly tender, chewy
3. Color: white or golden
4. Style: freedom from dark kernels, cob, husk, or silk
5. Consistency: thin, creamy, heavy
6. Flavor: natural, sweet, very sweet

The official stated that he could not see how any fair system of fixed grades could be arranged from these factors. He said that it might be possible to separate inferior grades on the basis of factors which were capable of physical measurement, such as size, uniformity, freedom from blemish, and color, but that the factors determining the higher grades could not be set objectively because they were largely a matter of personal taste. For instance, some people might believe a first grade of corn to be one that was packed in a very thin liquid, cream style, while others might consider this type as very inferior.

The executive believed that it would be almost impossible, furthermore, for the testing of the products to be free from human influence. It would be very difficult to make certain that the same standards of testing were used throughout the whole country, since personal judgment was so important an element.

Another troublesome point, according to the executive, was the determination of the range to be covered by each grade. With a perfect score equaling 100 points, grade A might range from 90 to 100 and B from 80 to 90, thus allowing a wide quality range for each grade. Or that range might be made much smaller, and more grades established. Most advocates of the legislation seemed to

believe that the use of a wide range, such as grade A equaling from 90 to 100, would be the most desirable.

The executive stated that the establishment of the latter system would be disastrous to a national advertiser such as the Rockwell Company, which for a number of years had spent many thousands of dollars in building up a high reputation for its products. Many of the products of the company under a compulsory grading system would score as high as 95 or better (on the purely measurable factors); but if every company scoring 90 or better were allowed to place the grade A mark on its label, the advantage of the superior product would be lost because the consumer would consider all grade A products to be the same. Consumers would not differentiate among grade A products, and consequently the goodwill which manufacturers had established by years of advertising and development of superior products would be destroyed. The consumers themselves would suffer from inferior quality under this system, since there would be a tendency for all packers to lower the quality of their products nearly to the minimum for a particular grade.

The officials of the company believed that the effect which compulsory grading might have on the sale of advertised brands of quality canned goods was indicated by the fact that some of the leading chain stores had announced voluntarily that they would adopt the suggested A, B, C, and D grading system. The chains, in the opinion of these officials, had taken this action partly to gain the resulting newspaper publicity, but more especially to take advantage of the resulting government sanction of their brands. In addition, the publicity which the government gave the A, B, C, and D grading system would furnish the chains with free advertising.

The executive of the Rockwell Company stated that the National Canners Association had proposed that a system of descriptive labeling be substituted for the compulsory grading system. Under this plan each packer would be required to place on his labels statements descriptive of the type of product in question and the manner in which it was packed. The elements which the Association recommended be included in descriptive labeling were as follows:

> In so far as it is practicable we believe the housewife is entitled to information as to the style or manner in which the particular commodity is packed (such as whole fruit, halves, or slices); the size or

sizes of the product (as in the case of peas); the number of pieces within a given range (as in the case of fruit or corn on the cob); information as to the maturity or texture of the product; addition or absence of seasoning (such as salt or sugar); information as to deficiencies in workmanship (such as freedom from husk, or cob); and certain other factors of informative value in the case of particular products (such as consistency in cream-style corn or density of syrup in canned fruits).[1]

The officials of the Rockwell Company were not entirely satisfied that the use of descriptive labeling would solve the problem satisfactorily. They considered that in packing corn, for instance, there were so many possible packing combinations that an enormous number of labels would have to be used. This large number would both confuse the consumer and complicate the inventory problems of the canners, distributors, and retailers.

The company's officers knew of a third proposal which they thought was superior to the two already mentioned. The advocates of this plan suggested that the provisions of the McNary-Mapes Law be expanded and enforced. This law, which had never been enforced, required that a special identification mark be placed on the labels of all canned goods which did not fulfill certain minimum requirements. The new proposal suggested that two minimums instead of one be set up. Under this plan the companies which packed goods falling into the lowest category would be required to use a plain white label without any brand name, showing only the name of the product and the packer. Companies packing goods in the next higher bracket would be allowed to use colored labels and brand designations, but would not be permitted to show any illustrations of the product. Companies packing superior grades would be allowed to include on the label whatever description, color, or illustration they desired, so long as it was in accordance with existing pure food and branding laws and regulations, and to include such additional descriptive matter pertaining to style and character (apart from quality) as might seem desirable.

The officials of the Rockwell Company believed it possible to establish standards which would differentiate inferior goods from the rest of the pack on an objective basis (size, uniformity, color, freedom from blemish, etc.), and they thought it justifiable to place distinguishing marks on such goods. But for goods which were not inferior in these respects, they believed the intangible

[1] *Ibid.*, p. 7.

factors to be so important that grading would be impossible. They were convinced that consumer purchases of canned goods were dictated by past experience with advertised brands, retailers' recommendations, and price.

What policy should the management of the Rockwell Company have formulated with respect to grade labeling? With respect to informative labeling?

In general, what attitude should the company have taken toward the Consumer Movement?

Appendix A

In 1941, under the sponsorship of the National Canners Association, a nationwide survey was made of the attitudes of women toward canned fruits and vegetables. Elmo Roper, a marketing consultant, was retained by the Association to conduct the study; and his staff personally interviewed 7,500 women eighteen years of age or over, distributed among the several economic levels, geographic regions, and city, village, and rural areas. The opinions of these women were sought on prices, on the adequacy of label information, on the degree of difficulty they experienced in selecting desired quality, on the extent of misrepresentation of quality, and on the factors they considered important as determining the quality of canned fruits and vegetables. A series of questions was also included to gauge how receptive these women were to grade labeling and how actively they desired it. The interviews were made from April 29 to May 12, 1941, and the report was published in June of that year. Mr. Roper's findings were as follows:

(1) A great majority of the public is satisfied with its experiences with canned foods, but there are enough instances of unsatisfactory quality to indicate the need for continued vigilance in the industry.

(2) The price of canned foods is not regarded as being at all unreasonable, but there are indications that certain other foods such as milk and fresh vegetables enjoy a definite price advantage in the mind of the public.

(3) Most people now buy canned foods by brand. Eighty-five per cent have no difficulty in picking out the quality or kind they want and most people are not aware of the absence of any important information on the labels of canned foods.

(4) There is very little active demand for grade labeling on the part of housewives generally.

(5) Despite this, more than half of the people showed a receptivity for the idea of grade labeling when we introduced the subject specifically to them. A third of our sample was willing to go so far as to say that it was "necessary and should be done."

(6) Much confusion exists as to what grade labels might mean. Of those who think it necessary, or a good idea, that the government grade all canned food, only 26.1% indicated a realization that grading is not an index to vitamin content and general nourishment.

(7*a*) There is such a divergence of opinion as to what are the most important factors of, or ingredients of, quality that any attempt at grade labeling would be almost sure to run the risk of creating a great deal of confusion among consumers. It seems highly likely that many women would not find the combination of factors that suited them best.

(7*b*) Even when given the opportunity to study a list of factors and to select *four* from that list, no one factor was chosen by as many as three-quarters of the women.

(7*c*) But even those who agree that a certain factor is an important quality determinant fail to agree on what actually is most desirable. This seems to us to add still further to the difficulty of finding a combination of qualities which will let anyone label a product "Best" and have it mean what a majority of women have come to regard as "Best."[1]

In Canada, since 1918, all cans of fruits and vegetables, whether domestic or imported, have been carefully inspected and labeled in one of four grades: fancy, choice, standard, and second quality. A study of certain aspects of the Canadian experience was made in 1934 by the Consumers' Advisory Board of the NRA in cooperation with the U.S. Bureau of Agricultural Economics in an effort to weigh the validity of some of the objections raised by canners in the United States to compulsory grade labeling of canned fruits and vegetables. Excerpts from the report of the Advisory Board under date of December 21, 1934, were as follows:

"Canner and trade opinion is behind the grading regulations in Canada, making the task of enforcement a routine matter for the authorities. Cooperative relations between the industry and the government agencies have developed over the long period of years during which the Meat and Canned Foods Act has been on the Canadian statutes. Avoidance of legal action in labeling disputes has been obtained by the expedient of placing the goods under temporary detention, pending a recheck on their actual grade ratings. There is a tendency to consider mislabeling an involuntary act, and every opportunity is given the canner to correct the statement of grade on his

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[1] Elmo Roper, *A Study of Certain Attitudes of Women toward Canned Fruits and Vegetables* (Washington, National Canners Association, 1941), p. 4.

labels. All canners interviewed are of the opinion that government is useful to their industry. No one of them would willingly abandon the system.

"Canadian consumers are gradually coming to use grade labels as guides in their buying. In Canada, as elsewhere, the professional sellers have more control over the manner of conducting business than have the amateur consumer buyers. Yet the compulsion to sell by grades keeps the prices of a retailer in line with those of competitors in the same district. This is particularly helpful as protection in poor districts where stores stock only Standard-quality goods and cannot successfully ask Fancy prices for them. In general, the Canadian consumer may buy solely by price and still be assured that her purchase falls within the grade uniformly marketed within that price range all over Canada.

. . . .

"Certain fears, entertained by some members of the United States canning industry, have not materialized under Canadian grading practice.

"The prices of like products in the same grade are not frozen to one level. The spread is often small, yet evidence appears that a product, either through advertising or superior merit or both, can command a premium over rival brands of the same grade.

. . . .

"The variations in price and quality within each grade demonstrate that Canadian canners do not try to produce foods just good enough to make the grade, but rather that they pack as well as they know how in order to obtain the higher prices to be had for goods of known attractiveness.

"The space taken by canning advertisers in Canadian publications is no less under grade regulations than before. Advertising by brand name is the rule; and such brand advertising assures the canner a cash premium for his goods over those rivals who do not thus pay to stimulate consumer interest.

"The cost of inspection and government grading is borne by the government itself. Through regular visits to canneries and through surprise visits to warehouses and stores, a comparatively small inspection staff manages to obtain compliance at a cost so low that the sanitary-inspection results alone would justify it.

"The Consumers' Advisory Board, on the basis of its findings in Canada, believes that the uniform grade labeling of canned fruits and vegetables would result in increased sales and better marketing conditions in the United States, and would put American consumers in a receptive mood for advertising based on a factual quality appeal."

The arguments for and against grading were reviewed by the Consumers' Division of the National Emergency Council in October, 1934. A summary of the conclusions on six of the arguments follows:

1. To the argument that it is not practical to measure quality so objectively that it will stand a court test on charges that the product did not meet the grade marked on it by the packer, the division stated that canners grade their packs to obtain warehouse loans and frequently use the Department of Agriculture grades for this purpose. The division thought it was only when the goods were sold to the public that difficulties about grading seemed to arise.

2. Against the argument that expensive court cases would have to be fought in connection with grade labeling, the division stated that, in spite of a 15-year requirement of grading in the Dominion of Canada, there had been no court tests necessary.

3. In reply to the point that consumers would prefer to buy by established brand names, the division argued that there were so many brand names on the market (4,000 of canned corn, for instance) that the consumer could not make an intelligent choice without expensive experimental buying.

4. To the canners' argument that the brand names of individual companies would lose something in goodwill value if government-established grades were used by the industry, the division replied that grade labeling might shift advertising emphasis away from unsupported claims toward detailed information about the product. The division stated that the advertiser would have the privilege of labeling the product and of describing why, within its grade, a particular product had peculiar excellence and was a good buy at the price.

5. To the point that the industry could not abide by grades dictated by the government, the Consumers' Division replied that the government was offering the services of its experienced agencies to cooperate with the canners' experts. The experience of Canada indicated that cooperative effort between business and government was wholly practicable.

6. To the canners' assertion that consumers would misunderstand grading and would believe that anything but the highest grade was undesirable, the division pointed out that in Canada the actual buying was on the following basis: 10% Fancy (grade A); 50% Choice (grade B); 40% Standard (grade C).

Appendix B

Some Notes on the Consumer Movement

In the 1930's there was, in the United States, a very marked development of interest in the consumer and her problems. This interest was a product of social and economic forces which had been at work over a long period;[1] but at this time the number and extent of organizations, activi-

[1] In *Labeling the Consumer Movement*, a report prepared by Werner K. Gabler for the American Retail Federation (published in 1939 by the Federation in Washing-

ties, proposals, beliefs, and plans which concerned themselves with the consumer reached such proportions that the term "Consumer Movement" came to have a definitely recognized meaning. By 1940 the Consumer Movement could be described roughly as follows:

Broadly, the Consumer Movement seeks to make the consumer a wiser buyer and user of the products which she acquires in her capacity as a consumer. Essentially the purpose is to raise the standard of living of the consumer by giving her a clear perception of her wants and needs and by furnishing her with information which will help her to satisfy them. This movement is a phenomenon of the modern economy characterized by widespread and detailed division of labor and the accompanying necessary exchange of goods and services through the mechanisms of the market place.

The frontier family was typically a producing unit. The housewife prepared the food for the family, she made their clothing, and she or her husband personally made any necessary repairs or alterations in the family dwelling. There were problems for the frontier family; but they were problems connected with deciding what to produce, how to produce it, and the like. There were obviously no problems related to fraud, deceit, advertising, and high-pressure salesmanship. Once the division of labor had been established, however, the real income in any family group was not literally what the family produced but what it succeeded in getting in exchange for its output; the forethought for family needs once put into producing was transferred to buying.

In the city family unit today there is relatively less production. Much clothing is bought ready-made. Food, to a great extent, is bought already prepared or very nearly so. Meals frequently are eaten in restaurants. Laundry for many families is done by commercial establishments. In apartments even minor repairs are made by the landlord. Producing is specialized and commercialized. Necessarily, therefore, the importance of buying has greatly increased. How high a standard of living can be procured with a given income depends not on how good a producer the housewife is but on how good a buyer.

American industry has produced for the home a vast array of labor-saving appliances and an immense variety of new articles which make life agreeable. But the skill of American industry in developing these products has advanced more rapidly than the knowledge of the consumer in using them. Today the housewife employs a great number of highly complicated electrical appliances, for instance—irons, refrigerators, mixers, vacuum cleaners, washing machines. For information

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ton), the following causes are discussed in some detail: the change from a rapidly expanding to a more stable economic system, the effect of the depression on the psychology of the American people, the change from a producer to an exchange economy, technological progress, the effect of modern marketing methods on the consumer, and increased interest in economic problems on the part of the American people.

on quality and price the housewife typically has to rely on commercial resources. She has no independent means of knowing whether a given product is a good value, whether it is genuinely suited to her needs, and how it compares with an apparently similar offering of some other manufacturer. She frequently makes her purchases on the basis of emotional or price appeals.

In purchasing and taking care of textiles, the housewife is similarly confused. When all fabrics were constructed from the four natural fibres—wool, cotton, linen, and silk—there was perhaps no great need for consumer protection; but now that a large number of synthetic fibres have been developed and are used alone or in combination with natural fibres, the consumer no longer is able to recognize the content of a particular fabric, she often cannot distinguish differences in quality, and she does not know what care to give the material in order to obtain the best service.

It was after the First World War that this greatly altered nature of the consumption economy began to make its consequences felt. The 1920's were a period of intense marketing activity, attended by much so-called "high-pressure" advertising and selling, during which the increased productivity of more highly specialized labor lifted the standard of living to levels never before achieved. But in spite of the material well-being of that period, there was growing uneasiness on the part of many who interested themselves in the problems of consumer welfare.

The year 1927 saw the publication of *Your Money's Worth*, the first of a series of "debunking" books attacking advertised merchandise. The authors, Stuart Chase and F. J. Schlink, discussed adulteration in foods and drugs, the large profits said to have been made by packaging simple products and giving them fanciful names, and the false or extravagant claims alleged to characterize much advertising. The book achieved wide circulation. In 1927 also, F. J. Schlink, one of the authors of *Your Money's Worth*, formed a club which later became Consumers' Research, Inc. This organization undertook to test nationally advertised products from the standpoint of the consumer and to assign ratings. The reports of Consumers' Research were available on a subscription basis. Within a brief period the number of subscribers was said to have reached 60,000.

Next came the depression years of the 1930's, bringing widespread unemployment, insecurity of income, general disillusionment, and a marked tendency to make business a scapegoat. In such soil the seeds of consumer discontent germinated rapidly; and the Consumer Movement, as an economic force to be reckoned with, quickly became a flourishing growth.

As a matter of fact, however, the interest in consumer problems goes farther back in the history of the United States than is implied in this brief account of the sudden growth in the 1930's. The earlier developments and the rapid acceleration of activities to further the

well-being of consumers are indicated, in some degree, by the following list of milestones.[1]

1845 First consumer cooperatives appeared in the United States.
1860 Grange movement began. It adopted the consumer cooperative idea.
1890 Sherman Anti-trust Act was passed. This was intended to furnish some protection to consumers by forbidding monopolies, combinations, or conspiracies in restraint of trade.
1906 Federal Food and Drug Law was enacted, providing some protection for the consumer against poisonous drugs and foods.
1908 American Home Economics Association was formed. Major emphasis at this time was on better use of purchased products and on better homemaking.
1912 *Good Housekeeping* certification service was established.
Sears, Roebuck and Company set up a laboratory to test part of its merchandise.
1914 Federal Trade Commission Act was passed. The Federal Trade Commission was designed originally to protect manufacturers and tradesmen against unfair competition, but its activities tended by indirection to protect consumers.
Clayton Act was passed. It expanded the provisions of the Sherman Anti-trust Act and specifically defined certain unfair practices.
1919 American Home Economics Association established Standards Committee of Textile Division to sponsor the research required to set up minimum standards for textiles sold at retail and to promote consumer education and use of standards.
1923 Bureau of Home Economics was organized within the U.S. Department of Agriculture to carry on research and education in problems of consumption.
1925 American Gas Association began the work of providing standards for gas appliances.
1927 First full year in which the Federal government offered facilities for grading meats.
R. H. Macy & Co., Inc., established a Bureau of Standards to test merchandise offered by Macy's. In the ensuing few years several other department stores set up testing laboratories. And in 1928 the National Retail Dry Goods Association established the Better Fabrics Testing Bureau, the facilities of which were made widely available for use by department stores, manufacturers, and others.
Your Money's Worth, by Stuart Chase and F. J. Schlink, appeared. It achieved wide circulation.[2]

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[1] For the form of listing, and for a part of the material in these notes, acknowledgment is due the report of Dr. Gabler previously referred to.

[2] Numerous other "debunking" books appeared within the next few years,

1929 Consumers' Research, Inc., was formally organized, largely as a result of the success of *Your Money's Worth.*
American Home Economics Association became affiliated with American Standards Association, which, since its founding in 1918, had confined its work exclusively to standards for industrial products.

1933 Consumers' Advisory Board was set up under the National Industrial Recovery Act. Thus, for the first time, the consumer was recognized as a partner in formulating the economic policies of the country. The Consumers' Advisory Board sought to protect consumer interests during the drafting of the codes of fair competition for the country's various industries. Its Committee on Consumer Standards advocated the formulation and greater use of standards on consumer merchandise.
Consumers' Counsel Division was set up under the Agricultural Adjustment Act to represent and protect consumers in the administration of the Act. As one of its undertakings, it published a biweekly *Consumers' Guide.*

1934 Consumers' Division of the National Emergency Council began functioning as a national clearing house for consumer information. Its program, as described in its publication *Consumer Notes*, was (1) to coordinate the work of the various agencies of the Federal government working in the field of consumer problems, (2) to provide a link between government agencies and consumers themselves, and (3) to help in every way the efforts of local consumer groups to translate a common viewpoint into terms of their local situation.

1935 On July 30, by Presidential executive order, a Consumers' Division was created within the National Recovery Administration. This division assumed the functions previously performed by the Consumers' Advisory Board of the NRA and the Consumers' Division of the NEC.
When the National Industrial Recovery Act was declared unconstitutional, consumer activities were shifted to the Department of Labor as the Consumers' Project. Subsequently development of the program was taken over, as the Consumer Standards Project, by the Consumers' Counsel Division of the AAA. Work on this Project was limited to research and education. Activities included, among others, collection of data on

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including the following:

100,000,000 Guinea Pigs: Dangers in Everyday Foods, Drugs and Cosmetics, Arthur Kallet and F. J. Schlink (New York, Vanguard, 1933).

Skin Deep, The Truth about Beauty Aids—Safe and Harmful, M. C. Phillips (New York, Vanguard, 1934).

Our Master's Voice: Advertising, James Rorty (New York, John Day, 1934).

Eat, Drink, and Be Wary, F. J. Schlink (New York, Covici, Friede, 1935).

The Popular Practice of Fraud, T. Swann Harding (New York, Longmans, Green, 1935).

Guinea Pigs No More, J. B. Matthews (New York, Covici, Friede, 1936).

laws, regulations, trade practice rules, and commercial standards in use to describe the quality and form of consumer goods; a study of laws, and the administration of the laws, relating to weights and measures; and a study of the relation of grades of meat to the palatability of meats.

Consumers Union was established by some former officers and employees of Consumers' Research, Inc. By 1942 the membership was reported to be in the vicinity of 50,000.

1936 Marquis Child's *Sweden, The Middle Way* was published and became a best-seller. It considerably stimulated public interest in consumer cooperatives.

Edward A. Filene, of Boston, set up the Consumer Distribution Corporation, a group designed to promote the organization and management of consumer cooperatives in the United States.

1936 American Standards Association organized an Advisory Committee on Ultimate Consumer Goods as the first step toward the establishment of standards of durability and serviceability for goods sold at retail.

A plank calling for consumer protection was incorporated in the platform adopted by the national convention of the Democratic Party.

The Administration sent a Commission to Europe to study consumer cooperatives. Its findings were published in 1937 under the title *Report of the Inquiry on Cooperative Enterprise in Europe* (Washington, Government Printing Office).

1937 Federal Trade Commission promulgated rules requiring disclosure of rayon content of fabrics. Rules subsequently issued required accurate labeling of silk products, of textiles containing mixed fibres, and of furs and garments employing fur.

Consumers' Counsel of the Bituminous Coal Commission was established by Congress, the first consumer body to be set up by Congressional action. (The Coal Commission and the Consumers' Counsel were abolished by the second reorganization plan, of May 9, 1939; and their functions were transferred to the Department of the Interior.)

National Consumer-Retailer Relations Council was formed, the first body established by consumers and retailers on an equal basis. Its membership, consisting primarily of national associations of consumers and national associations of retailers, included the General Federation of Women's Clubs, the American Association of University Women, and the American Home Economics Association, on the consumer side; and the National Retail Dry Goods Association, the American Retail Federation, and the National Association of Better Business Bureaus, on the retail side. The stated purposes were (1) to stimulate interest on the part of consumers, distributors, manufacturers, and the public in the value and use of adequate standards for consumer goods, (2) to promote the use of uniform termi-

nology in describing consumer goods and services, (3) to promote the use of informative labeling, (4) to promote the use of truthful and factual information in advertising, (5) to promote informative salesmanship, and (6) to develop and promote the use of suggested codes of ethics for both retailers and consumers.

1938 Institute for Consumer Education, an independent agency, established at Stephens College, Columbia, Mo., under the auspices of the Alfred P. Sloan Foundation. The program of the Institute included research, study, and education. Annual conferences on consumer education, drawing representatives from all over the country, were inaugurated in 1939.

Michigan set up the first state consumer department.

Congress passed the Wheeler-Lea amendments to the Federal Trade Commission Act, enlarging the power of the Federal Trade Commission to protect the consumer.

Congress passed the Federal Food, Drug, and Cosmetic Act, which gave better protection than the Food and Drug Act of 1906.

General Federation of Women's Clubs established a department of consumer education.

1939 Business-Consumer Relations Conference on Advertising and Selling Practices in the Financial, Merchandise, and Service Fields of Business was held in Buffalo under the auspices of the National Association of Better Business Bureaus. It was the first important conference devoted entirely to the discussion of Business-Consumer Relations.

1940 The Wool Products Labeling Act of 1939 became effective.

1942 Council of Organized Consumers, a federation of local, regional, and national consumer groups, was organized at the annual conference of Consumers Union. At the outset, it was planned to confine the Council's activities to informational work, centering on publication of a monthly bulletin on methods of promoting consumer-education projects.

Thus by the early 1940's a considerable number of agencies both inside and outside the government were applying themselves to consumer problems. In addition, certain large independent organizations established for other purposes had undertaken consumer activities, such as conferences, reports, and study programs, as a result of demand from their members. These organizations included the General Federation of Women's Clubs (2,250,000 members),[1] the American Association of University Women (61,500), the National League of Women Voters (48,000), the American Home Economics Association (82,500), the National Congress of Parents and Teachers (2,250,000), and the National Federation of Business and Professional Women's Clubs (70,000). Testing, information, and rating services were active.

[1] In this enumeration the figures in parentheses denote the approximate affiliated individual membership of the several organizations. The figures are Dr. Gabler's.

Besides the consumer-financed organizations, such as Consumers' Research, Inc., Consumers Union, and the Inter-Mountain Consumers' Service, there were a large number of services operated professionally or in the interests of business, such as the Good Housekeeping Institute, the Parents Magazine Advisory Service, the acceptance service of the American Medical Association Council on Foods, and the Fact Bulletin Service of the Better Business Bureaus.

As of 1942, the principal agencies of the Federal government interesting themselves in the consumer included the Consumers' Project of the Department of Labor (a remnant of the Consumers' Advisory Board of the NRA and the Consumers' Division of the NEC), the Consumers' Counsel Division of the AAA (likewise one of the agencies established during the early days of the New Deal), the Bureau of Home Economics of the Department of Agriculture, the Federal Trade Commission, the Food and Drug Administration, and the Consumer Division of the Office of Price Administration.

Under the Wheeler-Lea amendments the Federal Trade Commission became a major governmental agency for consumer protection. These amendments made unlawful unfair or deceptive acts or practices, as well as unfair methods of competition; and specifically declared unlawful the dissemination of false advertisements of foods, drugs, health devices, or cosmetics. Thus the authority of the Federal Trade Commisssion was greatly extended.

Initially the Federal Trade Commission had dealt with individual cases of unfair competition as they arose. Then for several years beginning in 1919 the trade practice conference procedure was in effect, under which members of entire industries voluntarily cooperated with the Federal Trade Commission in establishing Fair Trade Practice Rules for the wholesale elimination of unfair methods of competition and trade abuses. In 1937 the Commission began writing its own rules. The rayon rules were the first, requiring disclosure of the material content of merchandise containing rayon. In 1938, similar rules were issued with respect to merchandise containing silk; and still later a separate act was passed by Congress, the Wool Labeling Act of 1939, requiring full and accurate labeling of wool products. Beginning in 1938, furs and garments made wholly or in part of fur were required to be fully and accurately labeled; specifically (among other things) it was declared illegal to make false, misleading, or deceptive statements or representations concerning the grade, quality, substance, character, material, name, nature, or zoological origin of any furs or fur products. In 1938 also rules were issued requiring statement of the percentage of residual shrinkage, if any, in conjunction with such terms as "preshrunk" and "shrinkproof" on woven cotton goods. And in the case of mixed goods, each constituent fibre or material was required to be disclosed in the order of its predominance by weight.[1]

[1] For a convenient summary of Federal Trade Commission rulings applying to merchandise sold in department stores, see *The Retailer's Reference Book of Federal*

The Food and Drug Administration of the U.S. Department of Agriculture was charged with the administration of the Federal Food, Drug, and Cosmetic Law, which prohibited, among other things, the sale of adulterated drugs or cosmetics, the use of false or misleading labeling, and the use of misleading containers, and which required that labels on drugs and cosmetics carry the name and place of business of the manufacturer, packer, or distributor, a statement of the contents in terms of weight, measure, or numerical count, directions for use, precautions with respect to deterioration, and so on.

In the setting up of defense agencies the importance of the consumer's interests was recognized, and a Consumer Division was established in the National Defense Advisory Commission (May, 1940). This Consumer Division subsequently became a part of the Office of Price Administration and Civilian Supply, and later of the Office of Price Administration.

An important aspect of the Consumer Movement which should not be overlooked is the development of consumer education. Classes are conducted in public schools and in colleges, as well as among adult education groups, covering various topics designed to make consumers better buyers. At least 20 states are said to have fostered courses in the public schools which include projects and study materials in the field of consumer welfare. Affiliated student clubs of the American Home Economics Association are located in 47 states. The Consumers' Counsel Division of the AAA has listed 420 high schools which include the study of consumer problems in their curricula.

Because of the activities and utterances of enthusiasts belonging to the "lunatic fringe" inevitably attaching itself to such a cause, many authorities on marketing have been inclined to disparage the Consumer Movement. In contrast to this attitude may be cited the position taken by Neil H. Borden in *The Economic Effects of Advertising:*[1]

"The incompleteness of information in manufacturers' advertising has accounted not only for the interest of some consumers in informational labeling, but also for other moves by consumer groups to increase the fund of information regarding varying patterns of consumption and regarding the wise selection and proper use of products. Among the methods adopted by them are consumer education in schools and colleges and the formation of organizations to advise consumers regarding product choices.

"From the standpoint of maximizing consumer satisfactions, such movements and activities are to be deemed natural and desirable developments. A free society assumes the necessity of self-interest to guide the actions not only of producers but also of consumers. This assumption requires that consumers know what their interests are. As the range of products has increased, consumers have lacked the

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Trade Commission Rulings, published by the Merchandising Division of the National Retail Dry Goods Association (New York, 1939).

[1] (Chicago, Richard D. Irwin, 1942), pp. 672–673.

complete information needed to be certain of choosing the most satisfying of the options open to them. Moreover, sellers have been in a relatively dominant position in the matter of using influence in the exchange process. Each seller has been able to know his merchandise well, whereas the untutored buyer has had to learn the merits of thousands of items. Any moves made to strengthen the position of the buyer are deemed desirable, whether these be designed to make him wary in his buying, to help him get information which might supplement that gained in selling presentation, to train him how to use products in order to gain the greatest satisfactions from them, or to let him see clearly the probable satisfactions coming from alternative patterns of consumption. In spite of the many shortcomings of these consumer efforts they have come into existence to meet a need, namely, to help consumers improve their choices among merchandise offered.

"It is believed that sellers should recognize both the right and the desirability of individual consumers and consumer groups to be aggressive in furthering methods to educate other consumers and to provide additional desired product information. In keeping with the postulates of a free economy, this study of advertising has advocated freedom of choice and freedom in the use of influence. But the use of influence permeates a democratic society. If sellers use influence in their advertising and personal selling, then they must recognize that consumers on their part should be equally free to use influence."

As this volume goes to press, it is too early to appraise the effects of the Second World War on the Consumer Movement. It may be remarked, however, that one result which became visible in 1942 was the shift of much advertising to copy of an informative character, stressing means of prolonging the life of existing merchandise rather than seeking to promote further sales of new goods.

Broadly associated with, but in purpose distinct from, the Consumer Movement is the consumer cooperative movement. Dr. Gabler differentiates the consumer cooperative movement from the Consumer Movement as follows:

"Consumer cooperatives are a distinct section of the entire consumer movement. Consumer cooperation has a much wider scope than the consumer movement. Consumer cooperatives on the one hand fully back the major aims and purposes of the consumer movement. On the other hand, however, the consumer movement does not necessarily lead toward consumer cooperation. Many groups in the consumer movement are definitely opposed to consumer cooperation. A dissatisfied consumer movement, however, may easily lead toward increased interest in consumer cooperation.

" . . . What is a Consumer Cooperative? A consumer cooperative is a voluntary association of consumers whose purpose is to share (on the basis of use rather than profit) any savings that may be had by organizing under their own management the functions of production or distribution, or both. In this way they hope to get lower prices or higher quality for the goods and services they need by eliminat-

ing the usual retailer's, wholesaler's profits, and in some cases, manufacturer's profits and also by eliminating unwanted and unnecessary marketing functions at all three distributive levels."[1]

4. HARVARD COOPERATIVE SOCIETY, INC. (A)

PURCHASE OF AN ADDITIONAL BRAND OF HATS

In the summer of 1934 the men's wear buyer of the Harvard Cooperative Society, a store catering to students and alumni of Harvard University, the Massachusetts Institute of Technology, and Radcliffe College and to residents of Cambridge, Massachusetts, and near-by towns, discussed with the merchandise manager of the company the advisability of purchasing a stock of the Allen[2] brand of men's hats. He believed that the Allen brand would be a desirable addition to the merchandise in his department, because several customers of the store had told him that they thought Allen hats were superior to either Gilbert[2] or Johnson[2] hats, the two nationally advertised brands which the store already carried.

The store had sold both Gilbert and Johnson hats for a number of years because they appealed to the customers of the store. Sales of hats by the Harvard Cooperative Society during the year ended June 30, 1934, had amounted to $6,828. During that year the store turned its stock of hats 3.6 times. The Johnson hats sold at retail for $4 and $5, and the Gilbert hats for $4.95, $6.50, and $8. The manufacturers of Gilbert and Johnson hats, like the Allen Hat Company, regularly furnished their customers with free material for window and counter displays. The Harvard Cooperative Society, however, had found that much of this material was not useful.

Although the Allen Hat Company manufactured hats to retail for $5, $7, $8, and $10, the buyer proposed that only the $5 and the $8 hats be purchased. He had been fairly successful in estimating the number of hats which the store would sell in each size and price line, but he had found it almost impossible to predict which colors would be popular. He suggested, however, that the store buy three colors of hats in each price line in each of the following sizes: 6⅞, 7, 7⅛, 7¼, and 7⅜. Since the Allen Hat Company did not sell hats in units of less than one-fourth dozen in any size

[1] *Labeling the Consumer Movement*, p. 49.

[2] Fictitious name.

or color, the carrying of three different colors of hats meant that at least nine hats in each size had to be purchased. In the three middle sizes, moreover, the past experience of the store had shown that the desirable minimum in any line was at least six hats of each color. The Allen Hat Company would sell the hats to the store at prices which would permit a markup of 35% on the suggested retail prices of $5 and $8; thus an investment of $608.40 would be required if the Allen brand were stocked.

There was a difference of opinion between the merchandise manager and the buyer of men's wear with respect to the volume of additional sales that would be needed to justify the proposed investment in the Allen brand of hats. The buyer argued that a sales volume of $1,000 was adequate, whereas the merchandise manager believed that the company should not stock the new line unless the prospective sales would permit the maintenance of the old rate of stock-turn in the department. The merchandise manager questioned also whether the store, in view of the competitive situation, could obtain even the minimum volume suggested by the buyer.

In Cambridge there were five department stores that had total sales of about $4,000,000; twenty-seven men's furnishings shops, with total sales of approximately $800,000; and five combination men's, women's, and children's shops carrying men's hats, with total sales of about $300,000. In the trading area of Harvard Square near the Harvard Cooperative Society's store there were seven stores selling men's hats. Three of these were high-class stores—one carried a well-known advertised brand at $6, $7, and $8; the second, an unadvertised manufacturer's brand with a price range of $5 to $12; and the third, a private brand at $5 and $8.50 and an imported English brand at $9.85 and $12.50. Two of the remaining four stores sold their own private brands of hats at $4 and $5; another carried an unadvertised manufacturer's brand at $4.50 and its own private brand at $5; and the fourth carried the Johnson brand of hats at $4 and $5. No stores in Harvard Square carried the Allen brand of hats.

What sales volume on Allen brand hats would have been required to permit the maintenance of a stock-turn of 3.6 times?

Should the Harvard Cooperative Society have purchased Allen brand hats?

5. BLACK AND WHITE DEPARTMENT STORE

ANALYSIS OF LOSING DEPARTMENT

In March, 1931, the executives of the Black and White Department Store sought to determine whether or not the candy department, which had been highly unprofitable, should be discontinued.

The Black and White Department Store, located in the main shopping district of an eastern city with population of 200,000, had anuual sales of approximately $3,000,000. Its three major competitors, of which two also had sales of about $3,000,000 and the third, sales in excess of $10,000,000, all carried lower-price merchandise and appealed primarily to lower income groups. The Black and White Department Store offered charge accounts and delivery service to its customers. More than 60% of sales were made to charge customers, and a substantial proportion represented telephone orders. The store was open from 9:30 to 5:30 six days a week.

The candy department had been opened in May, 1930. Earlier in the year the first-floor departments, which included women's gloves, handbags, hosiery, neckwear, underwear, ribbons, notions, drugs and toilet goods, handkerchiefs, stationery, and men's furnishings, had been rearranged, making a prominent section of the floor available for a new department. The executives considered this space to be as valuable as any on the first floor. They believed that merchandise purchased by many customers largely on impulse should be sold in the space. They were reluctant to use such valuable space for a department which would serve only to bear a portion of the overhead expense of the store.

While the executives were considering possible uses for the space, the manufacturer of a line of well-known nationally advertised chocolates proposed that the store open a candy department. He offered an exclusive agency for his entire line, which included both packaged and bulk chocolates, and was willing to pay half the advertising expense of the department, the outlay to be determined by the store. Moreover, the manufacturer was willing to permit the store to return stale candy for full credit.

The executives of the Black and White Department Store considered the terms of the offer satisfactory. The candy was comparable in price and quality to the other merchandise carried

by the store. If the candy was sold at the manufacturer's suggested retail prices, the store would obtain an average markup of 38%.

The executives believed that competition would come primarily from a local chain of 15 stores which sold high-grade candy; other stores in the city carried cheaper grades of candy and would not, therefore, compete directly.

The new department was established in May, 1930. Two large showcases were stocked with packaged and bulk chocolates supplied by the manufacturer. Packaged chocolates came in ½-pound, 1-pound, 2-pound, and 5-pound boxes, the largest stock being in 1-pound boxes retailing for $1, $1.50, and $2. Bulk chocolates sold for 80 cents, $1, and $1.25 a pound, with the largest selection in the lowest price line. In addition, caramels, hard candies, assorted bulk candies, and 5-cent candy bars, purchased from local confectionery wholesalers, were stocked in relatively small quantities.

Decorations and displays were arranged to make the department colorful. Two attractive salesgirls were employed at $17 per week each. Advertisements were run in local newspapers featuring the brand name, quality, and price of the candy. A small display of packaged candies was placed in the store window. The notions buyer was put in charge of the candy department, and about 10% of her salary was charged to the department as buying expense.

From May 1, 1930, to January 31, 1931, the candy department failed to show a profit (see Exhibit 1). Expenses incurred in the immediate operation of the department were charged directly to it so far as possible. Rental charges were based on the estimated value of the floor space occupied, and delivery charges were based on the number of packages of a standard size delivered. All other expenses were allocated on the basis of the ratio of departmental sales to total store sales.

In March, 1931, several of the store officials favored discontinuing the candy department. In view of the unfavorable showing of the department they concluded that a department store could not sell enough candy to make a net profit, because most people were accustomed to buying candy in drug stores and candy stores. These executives had seen surveys which indicated that a substantial proportion of the buyers of expensive packaged candy were men, and they thought that men did not commonly patronize depart-

ment stores. Other officials argued that after the candy department had been operated for a longer period it might be able to show a profit. They thought that the sale of candy offered certain advantages to the store. Candy presented no markdown problems,

EXHIBIT 1
BLACK AND WHITE DEPARTMENT STORE
Results of Operation of Candy Department,
May 1, 1930—January 31, 1931

Item	Amount (9 Months, May 1, 1930–January 31, 1931)		Percentage (9 Months, May 1, 1930–January 31, 1931)		Median Percentages for Candy Departments of Department Stores with Sales of $2,000,000–$5,000,000: 1930*
Sales		$11,445		100.0%	100.0%
Cost of Goods Sold		7,463		65.2	
Gross Margin		$ 3,982		34.8%	31.7
Expenses:					
Administration	$ 786		6.9%		6.0
Occupancy	1,472		12.9		8.4
Publicity	814†		7.1†		2.8
Buying	215		1.9		3.4
Selling	1,952		17.0		12.4
Total		5,239		45.8	30.5
Net Loss		$ 1,257		11.0%	
Stock Shortages	$290			2.5	5.5
Discounts to Employees	453‡			3.9‡	3.7§
Number of Transactions	14,095				
Average Unit Sale	81 cents				
Average Retail Stock	$816				
Initial Markup	38.8% of Original Retail				38.6% of Original Retail
Stock-turn	14 times				10.2 times

* Source: Controllers' Congress of the National Retail Dry Goods Association, *1930 Merchandising and Operating Results for Department Stores and Specialty Stores* (New York, the Association, 1931), Table 3.
† Not including manufacturer's share of advertising expense.
‡ Employees were allowed a discount of 10% of the retail price on all candy except 5-cent bars.
§ Markdowns (including employees' discounts).

because unsold candy could be returned to the manufacturer. It attracted people into the store because the brand name was well known. Furthermore, the department was a colorful one from the standpoint of display. All the officials agreed that the candy department should not be retained if it could not be made profitable.

The merchandise manager in charge of the first floor suggested that the company install a costume jewelry department in place of the candy department. The store had never carried jewelry because the officers had felt that its class of customers preferred to purchase expensive jewelry from specialized high-grade jewelers. The executives had observed, however, that in recent years the popularity of costume jewelry[1] had increased materially, even among the well-to-do. In presenting his recommendation, the merchandise manager emphasized that he had not made a detailed study of this possibility; he pointed out, moreover, that the store's investment in advertising and equipment for the candy department should not be sacrificed until all possible methods for improvement had been explored.

Should the Black and White Department Store have discontinued the candy department? If not, what changes should have been made?

6. TILSIN COMPANY

SALE OF MEATS IN A GROCERY CHAIN[2]

The executives of the Tilsin Company, a chain grocery store organization, contemplated adding a full line of staple meats to the merchandise already sold by the company. This merchandise consisted of high-quality staple groceries, dairy products, citrus fruits, and dry vegetables. The Tilsin Company operated about 1,500 stores with annual sales of approximately $45,000,000. The stores were located within a radius of about 300 miles from the

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[1] In the jewelry trade the term "costume jewelry" was ordinarily confined to relatively low-price pieces, such as necklaces, bracelets, and brooches; such jewelry was fairly conspicuous and designed to complement or lend accents of color to the costume with which it was worn. It was usually of gold or silver plate or cheaper metals with imitation or semiprecious stones.

[2] *Chain store.* In the literature of marketing, there has been considerable confusion in the definition of the term "chain store." The Committee on Definitions of the National Association of Marketing Teachers said, "A chain store is one of a group of retail stores of essentially the same type, centrally owned, and with some degree of uniformity of operation."

From a statistical standpoint, number of units is the chief criterion to be used in counting chains. The Bureau of the Census, for its statistical classifications, does not consider a group of stores a chain unless it has more than three units. The Federal Trade Commission, on the other hand, in the chain store inquiry counted

company's executive office and warehouse. The territory served included portions of several midwestern states.

Officials of the Tilsin Company were aware that chain grocery store organizations in other territories sold meats in their stores with apparent success. According to a study of chain grocery operations, chains selling meats in combination with dry groceries and produce had earned in 1929 typically the same percentage of net profit, 1.4% of net sales, as had chains selling only dry groceries

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as chains organizations owning a controlling interest in two or more establishments selling substantially similar merchandise at retail.

The principal types of operation shown in the Census and their definitions are as follows:

Independents. Single-store independents and *two-store* and *three-store independents* are shown separately. Between them and the local chains is a classification called *local branch systems*.

A *branch system* differs from a local chain, although either can have four or more units, mainly in the method of merchandising and the relation of the various stores to each other. A branch system always revolves around a dominant parent store, from which the branches grew and from whose stocks the branches draw most of their merchandise for sale.

A *local chain* is a group of substantially similar stores under the same ownership and operation, merchandised from a central warehouse or other common point or points but not from the stocks of a parent store. In a local chain, a majority of the stores are located in and around one city.

A *sectional chain* is one whose stores are located in a number of cities so that its operations are more than local but a large majority of whose stores are located within one geographic division, or an equivalent area. Chains operating entirely or principally within the Pacific Coast states, or in New England, or in the South Atlantic states, or in any other distinct section of the country, are sectional chains.

National chains are those operating in two or more geographic divisions, or sections of the country, whose interests and operations are broader than those of any one section.

Manufacturer-controlled chains are operated to distribute at retail the products of a manufacturer or a group of manufacturers who are joint owners of the stores. Manufacturer-controlled chains are primarily interested in furthering the sales of predetermined commodities, in contrast to the primary interest of most stores and chains in determining customer preference and buying merchandise to sell which will most nearly fill that want. The interests of the two classes of merchandisers are different and require separate classification. Manufacturer-controlled chains are not classified as to the extent of territory covered. This classification includes sales branches of manufacturers of specialties, such as typewriters and plumbing fixtures, sold direct to the public at retail.

From an analytical standpoint, a statistical definition based on number alone overlooks important characteristics such as centralized management and control. From a management standpoint, the Census definition which follows has considerable significance: "A chain is a group of reasonably similar stores in the same kind or field of business, under one ownership and management, merchandised wholly or largely from central merchandising headquarters and supplied from one or more distributing warehouses or directly from the manufacturer on orders placed by the central buyers. Mere ownership is not the distinguishing feature, and there are many financial mergers of stores without central merchandising or buying which are not chains. Change of ownership does not necessarily change the method of operation, and as long as stores continue to plan and buy independently they are independents as far as type is concerned."[3]

and produce. The chains selling meats in addition to the other lines, however, had incurred higher total expenses.[1] A later study indicated that in 1932 chain grocery sales were about evenly divided between chains which offered meats and those which did not.[2]

In the territory served by the Tilsin Company, no important chain grocery companies were selling meats. Locally, therefore, meat was sold to consumers almost exclusively by unit meat or grocery stores or by chain meat markets.

Observers of the buying habits of consumers reported that there was a widespread desire on the part of customers to be able to purchase all food supplies at one store. In view of the successes already secured in other territories by chain stores offering meats, it was altogether likely that local chain store competitors of the Tilsin Company might expand into the meat business at any time. Even without regard to the probable actions of competitors, the officers of the Tilsin Company believed that the sale of meats in conjunction with groceries would stimulate sales of the latter, with consequently increased effectiveness of store operation.

Among its groceries the Tilsin Company stocked both manufacturers' brands and its own brands. The company's private brands, as a rule, had been developed only on products for which there was no outstanding manufacturer's brand enjoying widespread demand. By this policy the company avoided strong sales resistance to its own brands. When similar items were carried under both a manufacturer's brand and one of the Tilsin Company's brands, the store managers were instructed not to attempt substitution of one brand for the other when a customer expressed a specific preference.

It was the company's policy not to allow itself to be undersold by local competitors. Although adherence to this policy often meant selling individual items at extremely small margins, the executives were convinced that price was a dominant factor when consumers decided where to buy groceries. The company did not believe it possible, therefore, to maintain the volume of sales necessary to profitable operation unless its prices were as low as

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[1] Harvard Business School, Bureau of Business Research, Bulletin 84, *Expenses and Profits in the Chain Grocery Business in 1929*, by Malcolm P. McNair (Boston, the Bureau, 1931), p. 34.

[2] Harvard Business School, Bureau of Business Research, Bulletin 94, *Chain Store Expenses and Profits: An Interim Report for 1932*, by Malcolm P. McNair (Boston, the Bureau, 1934), p. 25.

those of competitors. On the other hand, quality was never overlooked; the company's object was to provide merchandise of uniform, dependable grade. Ability to meet price competition, therefore, depended on large-scale effective buying, economical selling, and reduction of operating expenses to a minimum. No credit or delivery services were offered.

The organization of the Tilsin Company had been developed for the purpose of operating grocery stores rather than stores combining both grocery and meat departments. The groceries, dairy products, citrus fruits, and dry vegetables were purchased centrally by a group of seven buyers located at the company's main office. These buyers were guided by the movements of stocks through the warehouse. Subject to seasonal and other special influences, the buyers placed orders on the basis of predetermined minimum stocks established for each item.

Mechanically, warehouse stock control records were kept on Powers machines according to the Davidson system. This system depended basically on the determination of standard units, shipments being expressed in terms of these units. For each commodity, the unit was determined by taking the total sales of that product for a year, expressed in units of packing, such as cases, sacks, or barrels, and dividing the sales by the total number of stores. The resulting figure was divided by 12 to yield a monthly figure for shipments of the commodity, and the monthly figure was divided by the usual number of times a month shipments of the product were made to stores. The final figure for total shipments made at each delivery interval then was adjusted to the most nearly corresponding unit of shipment offered by the vendors of the product. If the discrepancy between a shipment unit of the Tilsin Company and that of the vendor was large, the latter was asked to provide smaller, or otherwise more suitable, units of sale. Failing to secure such an adaptation, the company itself repacked the goods on receipt, so as to make them suitable for stock control purposes.

Seventy-five per cent of the goods purchased were delivered by the vendors direct to the warehouse and stored for weekly delivery to the individual stores in accordance with orders received from the store managers. Goods were charged to the stores from the warehouse at both cost and retail prices, although the invoice delivered to the store manager carried only retail prices.

The remaining 25% of purchases consisted of such items as milk, eggs, butter, crackers, and some products which manufacturers delivered direct to stores from warehouse stocks. For goods delivered direct to the individual stores, the vendors made out invoices at prices prescribed by the Tilsin Company in such a way that the store manager did not know the net cost of such merchandise. All purchase invoices, after being checked as to quantities delivered, were paid by the central office.

The managers of individual stores thus were held responsible for all goods received by them. They were charged for those goods either at retail selling prices, if delivery was made from the company's warehouse, or at vendors' advertised retail prices, for goods delivered direct by the vendors. On the latter type of goods, store managers were informed of the Tilsin Company's retail prices by means of letters from the central office.

At this office was centralized the control of sales and operations. The sales and operating committee, composed of five executives, was responsible for all operations after the goods left the warehouse, and for prices, display, and advertising, as well as for employment of field personnel, location of stores, and layout of merchandise within the stores.

The store layout of merchandise had been standardized on the basis of tests and analyses designed to show the most economical methods of arranging goods in the stores from the standpoint of size of investment, speed of selling, and attractive display.

Control over the store operations was maintained through a field organization representing the sales and operating committee. Directly responsible to this committee were four district managers, each of whom had charge of three district supervisors. Each district supervisor, in turn, was assisted by five to eight superintendents, each superintendent being responsible for the operation of 15 to 20 stores. All members of this field supervisory force were paid straight salaries. Store managers were paid weekly salaries and commissions.

Store managers were held responsible for the economical operation of their stores. They received instructions by letter from the central office, and they were also subject to the supervision of superintendents. Each manager, under the above restrictions, employed his assistants, ordered goods from the warehouse, and was accountable for all merchandise charged to him. No goods

were charged until the store manager had receipted the invoice; thereafter, he was expected to have either the goods themselves or their equivalent in cash to his credit. Cash was deposited daily in designated banks, and a weekly report was made out in each store. The sheet used provided for a weekly cash report; wages paid; minor expenses, that is, expenses of less than $2 per item; and a weekly merchandise recapitulation sheet. In addition, provision was made for a record of price changes, errors in invoices or deliveries, damaged goods, transferred goods, and containers returned for credit or for salvage.

For control purposes the central office maintained records according to individual stores for monthly gross margin and quarterly net profit. No departmentization of merchandise accounts by stores was undertaken. For the guidance of the central office executives, monthly reports were made up analyzing shipments to stores into 50 classes of merchandise. These reports showed the trend of sales for the company as a whole according to merchandise groupings. No similar analysis was made for individual stores, however, unless special circumstances made such reports necessary.

Reports were made monthly which showed for each superintendent the total sales and gross margins of the stores under the control of that superintendent. If a superintendent's showing in regard to sales or gross margin was unfavorable, the central office then proceeded to analyze the shipments to each store under that superintendent in order to detect the specific class or classes of merchandise which were unsatisfactory. This plan prevented the making of needless analyses of shipments and assured means of tracing down the causes of shortcomings.

A summary profit and loss account for the Tilsin Company for a typical year is shown in Exhibit 1.

By the addition of meats, the company would incur some losses in disposing of previously acquired leases and in costs of adapting store buildings to the combination activities proposed. The losses thus incurred probably would be recovered within a few months, if the plan should be successful. A combination store would require slightly more than twice the space needed for groceries alone. To justify the establishment of a meat section, the officers estimated that an individual store should be centrally located and should have attained a sales volume of at least $1,000 weekly. More than 100 of the company's stores filled these requirements. Some

changes in location would be necessary. New warehouse facilities also would be required.

It was estimated that total sales in stores selling both meats and groceries would be divided about equally between the two sections. A store of this type, to be successful, should have weekly sales of over $2,000, of which at least $1,000 would be in groceries.

EXHIBIT 1
TILSIN COMPANY
Condensed Combined Profit and Loss and Surplus Account for a Typical Year

Sales	$44,524,754
Less: Cost of Sales	34,085,170
Gross Margin	$10,439,584
Deduct: Operating, Selling, General, and Administrative Expenses	8,670,351
	$ 1,769,233
Add: Interest, Dividends, and Rent Received, less Interest Paid	55,470
	$ 1,824,703
Deduct: Depreciation on Fixed Assets	291,104
	$ 1,533,599
Deduct: Provision for Federal Taxes	232,992
Net Profits for Year to Surplus	$ 1,300,607

If it entered the meat business, the company would face a number of obstacles. The handling of meat in a retail store was quite different from the selling of groceries. In addition to physical requirements for refrigeration, handling, and effective display, there were important considerations involving personnel. The supply of competent butchers who would act either as managers of meat sections or as meat cutters in these sections was scanty. Effective cutting and preparation of meat required skilled employees. The carcass of an animal such as a beef steer, for instance, contained many different cuts of meat, each cut bringing a different retail price. Thus, market quotations on retail prices of beef on a typical day contained the following items:

Steak—Sirloin 49 cents a pound, tenderloin 63 cents a pound, porterhouse 53 cents a pound, top of the round 42 cents a pound, bottom of the round 28 cents a pound.

Roasts—Sirloin 42 cents a pound, sirloin roll 43 cents a pound, first two ribs 39 cents a pound, first three ribs 31 cents a pound, fourth and fifth ribs 25 cents a pound, fifth rib 21 cents a pound, face of rump 28 cents a pound, heel of rump 25 cents a pound, back of rump 28 cents a pound, chuck roast 24 cents a pound, bottom of the round 28 cents a pound, top roll 21 cents a pound, pot roast 21 cents a pound.

Use of unskilled or careless meat cutters might mean substantial waste and loss through neglect to distinguish properly between

the more and the less valuable cuts. Thus, a careless butcher might include a substantial portion of a 50-cent cut in making up a 30-cent cut of meat. Proper cutting in relation to bones and waste portions of the carcass was necessary to prevent discrimination between customers and losses to the company. Losses from careless or unskilled cutting, it was estimated, might run as high as 5% of the net sales of meat.

In addition, meat usually was purchased, warehoused, and delivered to the retail markets in large pieces, sometimes including entire carcasses. Under such conditions it was impossible to foretell the number and poundage of the various cuts in a large piece of meat. Except for a few items such as packaged sausage, no sufficiently accurate standardization of meat shipments could be made to permit applying retail prices in advance to meats delivered to stores. Hence, the warehouse stock control plan as outlined above could not be applied to the handling of meats. Relatively, only a rudimentary type of unit stock control could be kept for meats. A high stock-turn in meats was essential to assure attractive, wholesome stocks.

Some chains with a large volume of meat sales had been experimenting, apparently successfully, with centralized warehouse cutting of meats into the types and sizes of cut most frequently demanded. It had been said that even in such chains, however, a substantial portion of consumer demand was for unusual sizes and types of cut, which made necessary the continued employment of skilled butchers in the retail stores to handle such orders, as well as to dress fowl.

Some meat could be purchased locally, but much of it would be ordered in car lots from the Chicago plants of large meat packers. Delivery in car lots could be made direct to the meat warehouse of the chain market. The delivery of meats to stores required trucks of a different type from those used for groceries. Meat deliveries to stores presumably would be made three times a week, whereas grocery deliveries usually were made weekly.

The stock-turn was once in five weeks for the Tilsin Company's general grocery inventory as a whole, although merchandise remained in the stores for an average of only 2½ weeks.

On the basis of information secured from noncompeting grocery chains, the officials of the Tilsin Company estimated that a gross margin of about 25% could be obtained on meats, provided the store personnel was fully effective. Store expenses, including the

prorated share of all central office expenses, were estimated at 20% of sales for meats, whereas they were 18% for groceries. Store labor alone was figured at 10% of meat sales and at 8% of grocery sales. It was possible, however, that this 8% would be reduced somewhat in combination meat and grocery stores if the sales of groceries were increased. Officials of the Tilsin Company expected that in combination stores the sales of groceries might increase 10% and that such an increase could be handled without additional store employees.

The officers of the Tilsin Company knew that stores selling meats alone commonly had expense ratios considerably higher than those of grocery stores and grocery and meat combination stores, as shown in the following table:

OPERATING EXPENSES PER $100 OF SALES

Stores	1933	1929
Grocery Stores	$20.00	$17.36
Combination Stores (grocery and meat)	19.90	16.10
Meat Markets	27.50	19.61

Source: U.S. Bureau of the Census, *Census of American Business: 1933, Retail Distribution* (Washington, the Bureau, 1935), Vol. I, p. 20.

This adverse relationship of expenses for retailing meats was accepted as being representative of the operations of meat stores in the territory served by the Tilsin Company.

Meat prices would be established centrally, as was done for groceries, and communicated by letter to the store managers. The responsibility for applying the prescribed prices to the proper cuts of meat necessarily would be left to the store meat managers. Prices per pound on the various kinds of meat would be displayed conspicuously in the stores. In order to keep track of the margin actually obtained on meats, each combination store would have to use a separate cash register for the meat section.

The typical organization in a combination store would be approximately as follows:

GROCERIES	MEATS
Store manager	Manager
Two assistants	Cutter
One boy	Two clerks (one to sell fruits and vegetables)
	Cashier

Thus each combination store would have two managers, one for groceries and one for meats. The manager of the meat section would be supervised by an organization separate from that supervising the grocery section, but the same chief executives would manage both supervisory divisions. No serious friction between the dual managers of a store was expected, since both would receive substantially the same compensation and each would have a distinctive part of the store to control.

The treasurer of the Tilsin Company had reported that the company readily could finance the program.

Several operating aspects of the problem already had been reported on, in part, as follows:

Because of the variations in cuts, the selling price of a whole carcass cannot be accurately determined in advance of cutting. Furthermore, the buyer cannot tell how much of the various kinds of cuts he is getting when he purchases a lot of carcasses. The units of sale also lack standardization to a large extent. Cuts must be adapted to the type and quantity desired by the individual customer.

Meats are subject to marked variations in demand. Different parts of the country and even different districts of one locality desire different types of cuts from the same sort of carcass. Demand also discriminates closely between grades as well as between cuts. In addition, demand varies from day to day in respect to the kinds of meat required. Pork chops may constitute the majority of sales for one day of the week and chickens of another. Because of the difficulties of adjusting supply to demand, meats are subject to frequent fluctuations in price. When one considers the standardization and nonperishability of most grocery products and also the relative stability of the demand and prices, one appreciates the differences in the character of meats and grocery items.

Centralized purchasing is an essential feature of a chain store organization. Buyers specializing on certain lines of products seek out the most economical and reliable sources of supply, and with their buying power as an aid, endeavor to secure the most advantageous terms that are possible.

Buyers for a meat chain, however, will encounter several difficulties. The lack of standardization and uniformity of the product makes purchase on description not altogether satisfactory. In order to be sure that the proper quality is obtained, complicated sets of standards for the packer to observe may have to be issued. Compliance to such standards would undoubtedly be difficult and when orders are large the packer may find himself short of a sufficient quantity of the desired quality to fill the order. The buyers, therefore, might not be sure of getting just what they wanted.

The responsibility for judging daily demand will fall partly on the shoulders of the buyers and partly on the shoulders of the store managers. The difficulty of using purchase control records, because of lack of standardized units and for other reasons, and the extent to which demand is affected by weather and other day-to-day influences which control records would reflect, make this an important problem.

Many grocery chains have a form of stock control similar to the one being used by the Tilsin Company. Such a control allows a close supervision over purchasing. The buyer is automatically informed of when to buy, what to buy, and how much to buy. In these important elements of purchasing the buyer has but little discretion and can devote his time to studying the sources of supply. This control, furthermore, allows the stock-turn to be maintained at high levels because once the relation of stock to sales has been determined, the control method almost automatically keeps it in adjustment. Such a highly developed form of physical inventory control, however, is not readily adaptable to the handling of meat.

In view of the standardization of grocery products, prices and quality are well known to the consumer, and therefore the consumer is quick to discover where he can get the best quality at the lowest price. For this reason chain grocery stores can compete on a price basis. Most customers, however, cannot tell the quality of meat by looking at it.

Should the Tilsin Company have undertaken the sale of meats?

7. JOHN SHOBER

LEASING THE WOMEN'S WEAR CONCESSION IN A SUPERMARKET[1]

In May, 1935, John Shober was approached by Mr. Estes, the general manager of the Midwest Market Corporation, with the proposal that he lease the women's wear concession in the supermarket operated by the corporation. Mr. Shober for many years had owned and actively managed a store selling low-price women's wear in one of the secondary retail sections of a large city. Early in 1935, he had taken a lease on the women's wear concession in a supermarket located in a small industrial city about 30 miles away.

[1] A *supermarket* is a large food store, as distinguished from a public market or a farmers' market. Beyond this, there is no complete agreement as to what constitutes a supermarket. Whether a supermarket must include a meat department, whether it must limit customer service to self-service and cash-carry or may offer full service, and what minimum sales volume is required of a food store before it may be classified as a supermarket are debatable points in the definition. Because of the absence of agreement as to definition, the Bureau of the Census in the 1939

It was his success in this venture which brought him to the attention of the manager of the Midwest Market Corporation.

Mr. Estes had thought of adding a low-price women's wear concession more than six months before and had found a man to undertake the lease. Sales had not been satisfactory, however, and the arrangement had been terminated. Mr. Estes believed that the failure was due to poor selection of merchandise and its unsatisfactory quality rather than to the location of the department or any aversion on the part of customers to the purchase of women's wear in a store of this type. It was his opinion that a soundly merchandised women's wear concession could be operated at a profit in the Midwest Market Corporation's store.

If Mr. Shober decided to lease the concession, he would be subject to the usual restrictions which the management imposed on all concessionaires. The concession would occupy 1,200 square feet of space in the rear corner of the store between the drug department and the liquor department. Customers who wished to make purchases in it would have to pass through the grocery department. Mr. Shober would pay a rent of 8% of sales and an additional 2% of sales for advertising.

Census of Business refrained from using the term "supermarket" as a Census classification but reported the following data for large food stores:

	Grocery and Combination Stores					
	Total including Self-service		Self-service Stores			
			Independents		Units of Chains	
	Stores	Sales (000 omitted)	Stores	Sales (000 omitted)	Stores	Sales (000 omitted)
Total Reported......	387,337	$7,721,753	19,642	$737,245	11,541	$1,489,844
Stores with Sales:						
Under $50,000.....	354,284	4,135,304	15,505	291,600	2,869	86,255
$50,000–$99,999...	22,757	1,540,212	2,816	191,977	3,772	276,713
$100,000–$299,999.	8,849	1,335,840	1,175	176,172	3,822	620,703
$300,000 and over.	1,447	710,397	146	77,496	1,078	506,173

Source: U.S. Bureau of the Census, *Census of Business: 1939, Supermarkets and Self-Service Food Stores* (Washington, Government Printing Office, 1941), p. 3.

In testifying before a subcommittee of the Committee on Ways and Means of the House of Representatives on April 26, 1940, Professor McNair introduced the following statements in regard to supermarkets:

"No satisfactory definition of a supermarket has yet been composed. Volume of sales is not an adequate criterion, although the sales of the supermarkets are

In the event that he decided to lease the concession, Mr. Shober planned to sell house dresses, sweaters, low-price silk dresses, hosiery, underwear, and blouses. Price lines would probably be set at about the following figures: house dresses, 55 cents (2 for $1), 75 cents, and 95 cents; afternoon dresses, $1.50, $2.50, and $4; sweaters, $1 and $1.95; hosiery and underwear, from 29 cents to $1. The average sale for the department was expected to be under $1. Most of the merchandise purchased would be job lots and close-out goods. Mr. Shober estimated that weekly sales in the concession would be about $800 and that he would need an average stock of $2,500. From previous experience he thought that a gross margin of 30% could be obtained. Because of the nature of the merchandise carried, markdowns would be negligible. It would be necessary to have five salespeople to wait on customers in the rush hours of the evening and all day Friday and Saturday and probably at least two the rest of the time. The total salesforce expense,

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very much larger than the sales of the average grocery store. Some distinguishing features of the supermarket may be enumerated without attempting a definition.

"1. Generally it is a self-service market.

"2. Generally it is a departmentized market, and the food section is departmentized, and the latter is the most important, or one of the most important, parts of the market.

"3. Generally it has a much larger floor space than the average-sized store (5,000 feet and up).

"There are three general types of supermarkets:

"1. The public market, a place where a number of merchants lease space in the same building and operate their businesses independently.

"2. The supermarket, in which the owner operates one section, generally the grocery section, and leases the rest of the space to operators in noncompetitive lines. Probably this is the type of market originally regarded as a supermarket.

"3. The market which does not lease concessions. It is owner-operated and generally it is a complete departmentized food market and does not carry other lines of merchandise, or carries only a limited number of other lines.

. . . .

"The record clearly establishes the fact that individual merchants or wholesalers preceded the food chains into the supermarket field. It was about 1935 that the old-line chains began to give serious consideration to supermarket operations. The food chains were led to this step for two principal reasons: (1) The competition of independent supermarkets which very generally undersell the regular chain and independent food stores, and (2) the spread of discriminatory chain-store taxes in State legislatures—taxes that are based on the number of stores operated by each company. Supermarket competition took such a large volume of business that chain operations in certain areas became unprofitable. This competition necessitated the adoption of this more economical form of distribution or withdrawal from the area."—*Hearings* before a Subcommittee of the Committee on Ways and Means, House of Representatives, Seventy-Sixth Congress, Third Session, on H.R. 1, A Bill Providing for an Excise Tax on Retail Stores (Washington, Government Printing Office, 1940), Vol. 2, pp. 1286–1287.

exclusive of the manager, would be about \$60 a week. Because he had a nephew with some experience in the business who would take active charge, Mr. Shober believed that the concession would not require much of his own time.

As bases for determining whether to accept the proposal, Mr. Shober had to appraise the opportunity for selling women's wear profitably in a store such as that operated by the Midwest Market Corporation and the probable future of the supermarket itself. Also he had to consider the managerial and supervision problems which would be entailed. The new enterprise would divert his attention from the management of his own store, and this difficulty would be accentuated if the Midwest Market Corporation should decide to open new stores in which he would be expected to lease the women's wear concessions.

The Midwest Market Corporation operated a single large retail food market serving towns and cities within approximately a 10-mile radius of the store. It was directed by Mr. Estes, who had been engaged for many years in various phases of wholesale and retail food distribution. In 1932, when the chain grocery store company of which he was an executive was purchased by a competitor, he became interested in large, centrally located food markets, many of which had been opened in various parts of the country in 1930 and 1931. After studying stores of this type for several months, Mr. Estes secured associates, capital, and a store location, and opened his store in May, 1933.

The store occupied the first three floors of a well-built, four-story building which formerly had been a factory. The 10-year lease stipulated a rental of 1% of all sales made in the building, with a minimum yearly payment of \$5,200 and a maximum of \$15,000. The building, served by a private railroad siding, was located only a few miles from a large city which was an important food-distributing center. The store's parking facilities, including one section for which the store paid a rental charge of \$50 a month, accommodated approximately 2,000 automobiles. Over 500,000 people resided within 2½ miles of the store, and there were a number of cities and residential suburbs within a radius of 10 miles. Two main traffic arteries and two bus lines passed by the store property.

This supermarket attracted all types of people, some of whom drove to it in cars with chauffeurs. A brief check on automobile registrations showed that almost 25% of the cars came from areas

more than 10 miles distant. Although women shoppers predominated, the proportion of men appeared to be considerably higher than for other grocery stores.

All selling was done on the first floor; the second and third floors were used for offices and storage. The selling section was laid out to facilitate self-service and to secure the maximum benefit from the available space. The meat, candy, cracker, and vegetable departments were placed near the front in order to take advantage of impulse buying. The movement of traffic was from the front of the store to the rear and back again. There was no exit at the rear of the store.

Although the Midwest Market Corporation itself was engaged solely in the retail distribution of dry groceries and canned goods, it leased parts of its selling floor space to the following concessions: meats and fish; fruits and vegetables; dairy products (butter, eggs, cheese, etc.); drugs and cosmetics (typical drug store line, but no prescription business); flowers (cut flowers, plants, shrubs); crockery (including chinaware and aluminum kitchen utensils); lunch counter; radio (including electrical refrigerators and some electrical supplies); automobile accessories (including tires); shoes (including hosiery); bakery goods (bread, pies, doughnuts, etc.); paints (including wallpaper, brushes, plumbing supplies, and linoleum); tobacco; candy; crackers; haberdashery; and coal (a representative of a local coal company, who showed samples and took orders). The public generally did not realize that all departments were not operated by the Midwest Market Corporation.

With the exception of the drug and lunch concessions, which were managed by one lessee, the several concessions were operated by different firms. The store secured the lessees by solicitation among firms already operating concessions or retail stores and insisted that the lessees have proper backing and experience. The store attempted to attract concessions that would enable it to offer a complete line of household goods. The store charged the lessees rentals which varied from 3% to 12% of sales and averaged 7%. The rate for a particular concession was based on its probable gross margin, the space required, the expected volume, and the probability or improbability of its being a temporary venture. In addition to the rental charge, the store charged 2% of the net sales of the concession for advertising. In return for these charges, it furnished selling and storage space, heat, light, and advertising.

The operator of the concession furnished his own equipment, stock, salespersons, clerical help, and management.

The Midwest Market Corporation retained considerable control over the concessions. It gave them lease contracts running for one year, but subject to cancellation by the store for any or no reason on 10 days' notice. It required them to use an approved type of cash register, the recording devices of which it locked and sealed. The management sent a checker to each concession every morning to check the sales for the previous day, and on Monday morning to collect payment for the previous week. The management reserved the right to remove goods from concession counters if those goods appeared to be below the store's quality standards. It was able to require price reductions on individual items sold by the lessees, and it sent out shoppers to compare concession prices with those of stores selling similar items. The management, furthermore, was authorized to discharge concession employees or to require the hiring of additional employees.

The leased concessions employed salespersons, but the grocery department was entirely self-service. Customers buying grocery products passed through the front of the store, picked up baskets near the cashiers' stalls, and went into the main part of the store to select the goods which they wanted. The groceries were placed on open display tables, each table holding related types of products. A customer was able to locate the desired table by means of overhead signs. The price of each item of merchandise was plainly marked, both at the top of the table and on each package or can. A customer examined goods, put what he wanted in his basket, and went to the cashiers' stalls. A cashier emptied the customer's basket on a counter, computed the total amount of the purchase by listing the individual amounts on a combination adding-listing machine and cash register which delivered a printed list for the customer, and collected payment. Bundle boys then put the goods into paper bags and handed them to the customer or helped in carrying the merchandise to the customer's car. The 16 cashiers formed the bottleneck of the grocery section of the store. When they were unable to keep pace with the customers, the store's doors were closed and no additional customers were allowed to enter until the congestion had cleared.

The Midwest Market Corporation's store was open every day except Sunday from 10 a.m. until 10 p.m. Sales peaks occurred

between 6 p.m. and 10 p.m., and Friday and Saturday were the busiest days of the week. Sales to dealers were eliminated so far as possible by the setting of definite quantity limits on all special-sale items. Returned goods were accepted without question, provided they were not damaged. Neither the grocery department nor any of the concessions granted credit or delivery service. The store allowed no discounts other than the ordinary quantity prices on particular items. Employees throughout the store were paid straight salaries, the minimum being $15 a week.

Although the Midwest Market Corporation's private brand was used on a few items such as mayonnaise, coffee, tea, and vinegar, the store preferred manufacturers' brands because they were better suited to self-service selling, attracted people to the store, and facilitated price comparisons with competing stores. These goods generally were sold with a 10% markup. Since chain grocery stores on the average obtained gross margins of approximately 22%,[1] the management of the Midwest Market Corporation believed that it was able to offer standard grocery products for almost 10% less than chain stores. Price leaders and the generally lower level of prices were advertised in a local radio program, in a few local newspapers, and in handbills, which were distributed on Thursday of each week within a radius of about 5 miles of the store.

Sixty per cent of purchases were made direct from manufacturers, and 40% from wholesalers who sold in carload lots and took the manufacturer's cash discount, normally 2%, as their entire profit. The latter method was used to circumvent the refusal of some manufacturers to sell direct to a store of the Midwest Market Corporation type.

Competitors did much to hamper the development of the enterprise. The greatest single handicap imposed on the new store was the attempt to prevent it from buying direct from manufacturers. Several competitors threatened to stop buying from any manufacturer who sold direct to the store. This threat was successful in a number of cases. A few manufacturers went further and not only refused to sell direct to the store but attempted to prevent the store from buying through wholesalers at the direct-sale price. Competitors also induced a number of wholesalers not to sell to

[1] Harvard Business School, Bureau of Business Research, Bulletin 94, *Chain Store Expenses and Profits: An Interim Report for 1932*, by Malcolm P. McNair (Boston, the Bureau, 1934), p. 26.

the new store under the arrangement whereby the wholesalers sold in carload lots and took the manufacturer's cash discount as their entire profit. Although the difficulty of securing and maintaining sources of supply had lessened, it continued to be the store's most serious problem.

Should Mr. Shober have leased the women's wear concession from the Midwest Market Corporation?

Should either the Dever Company (p. 579) or the Atlas Wholesale Grocery Company (p. 595) have undertaken to operate supermarkets?

8. TREVELYAN MOTOR COMPANY

OPERATING PROBLEMS CREATED BY BAN ON SALES OF NEW CARS

Early in January, 1942, Mr. Trevelyan, the president of the Trevelyan Motor Company, called a meeting of the company's several department managers to consider the advisability of adding a new product line in order to offset the loss in revenue caused by the ban imposed by the Office of Production Management on sales of new cars.

The Trevelyan Motor Company was located in a large suburb of an eastern metropolis. It leased a single-story building containing 40,000 square feet of floor space. The new car salesroom and executive offices were on the main floor; the service and repair department and the reserve stock of cars were in the basement. For its used car business the company leased two adjacent lots with a total area of 50,000 square feet. The Trevelyan Motor Company sold a complete line of Ford, Mercury, and Lincoln cars, and was not only the largest automobile dealer in the area but one of the largest Ford dealers in the country. Its sales volume in 1941 from all sources—new car sales, used car sales, service, and repairs—was approximately $2,000,000. The company maintained a complete service and repair department which was prepared to furnish all types of service, repairs, and installations for Ford-manufactured cars. The equipment of this department included all the bench tools commonly used for automobile repair work and, in addition, the following:

4 electric hand drills
2 wall drills
3 grinding machines
2 buffing machines
5 battery chargers
2 machines for testing spark plugs
2 hydraulic lifts
1 machine for testing compression
1 machine for testing wheel alignment
1 welding outfit
1 spray booth

The personnel of the organization comprised the president, the new car sales manager, the used car sales manager, the service and repair manager, eight new car salesmen, three used car salesmen, six clericals, three servicemen, two car washers, and one handy man. The service and repair manager and the three servicemen were highly skilled mechanics capable of making both diagnoses and repairs. The two car washers and the handy man, although not classified as skilled mechanics, were competent to make minor repairs.

In October, 1941, Mr. Trevelyan had anticipated that a ban would be placed on sales of new cars, and in the ensuing months he had endeavored to secure some sort of defense subcontracting work which would enable him to keep his organization together.

On November 1, he visited the Norton Company, a large manufacturer of abrasives, which, as a prime contractor, was in a position to give subcontracts on government work. He furnished a detailed statement of the personnel and equipment available in his organization; and after a study of this statement, the executives of the Norton Company expressed the opinion that with additional machinery the Trevelyan Motor Company could be granted a subcontract. Mr. Trevelyan, pleased with the outcome of the interview, decided to procure the necessary machinery; but when he attempted to place the order, he was informed that he did not have the necessary priority rating to secure it. Hence he was unable to proceed in his negotiations with the Norton Company.

On November 15, he talked with executives of the United Shoe Machinery Company relative to possible subcontracts for them. He explained that he was attempting to secure subcontracting work in order to hold together his experienced organization, but he was informed that the United Shoe Machinery Company could

use practically all his personnel but would not be able to grant him any subcontracts because of his insufficient equipment.

On November 30, Mr. Trevelyan discussed his position with Floyd Odlum, Director of the Division of Contract Distribution of the Office of Production Management. Mr. Odlum said that he appreciated Mr. Trevelyan's position but could not give him any assistance. Equipment was one of the deciding factors in the letting of contracts; and since Mr. Trevelyan's company did not have the necessary equipment, a defense contract was out of the question.

On December 3, Mr. Trevelyan was granted an interview by the officer in charge of contracts at the Boston Navy Yard. This officer informed him that with additional equipment he could be listed as a possible subcontractor to make paravanes for torpedoes. Since he lacked this equipment, however, it would be senseless to put his name on the list.

On December 10, Mr. Trevelyan talked with a representative of the General Electric Company, who offered him a 30-ton girder to bore and ream. But Mr. Trevelyan's existing equipment could not cope with such an order; and here again negotiations came to a standstill.

On December 17, Mr. Trevelyan traveled to Washington to talk with Cyrus McCormick, of the automobile and truck division of the OPA. The latter suggested that Mr. Trevelyan persuade a number of dealers to pool their equipment and that he set himself up as the prime contractor for the group. This latter step was necessary since the government refused to grant a defense contract to any pool unless it was headed by a prime contractor who assumed all responsibilities. Mr. Trevelyan did not care to assume the responsibilities of a prime contractor.

Somewhat discouraged by his inability to find subcontracting work but still determined to remain in business, Mr. Trevelyan undertook to reduce his costs of operation and to augment his revenue from other sources than the sale of new cars. The original budget and the revised figures for the Trevelyan Motor Company for the year 1942 were as shown in Exhibit 1. Under the revised plan it was necessary to dismiss four of the new car salesmen, two of the used car salesmen, and three of the clericals. The other employees, retained because of seniority or productive capacity, were shifted about in the interests of greater efficiency. Thus two of the new car salesmen were transferred to the used car lot; and the

used car salesmen, together with the handy man, were transferred to the service department. By these means the budget for wages was reduced by nearly $40,000. The planned advertising expenditure of $15,300, of which $11,000 had been intended for new car advertising, was cut to $7,800, all to be applied to the advertising of service and repairs and of used cars. Light and heat expenses were expected to be reduced by $3,000 through the elimination of all

EXHIBIT 1
TREVELYAN MOTOR COMPANY
Original and Revised Budget for 1942
(Revision after Ban on Sales of New Cars)

	Original		Revised	
Sales:				
New Cars	$900,000		$150,000	
Used Cars	450,000		450,000	
Service and Repairs*	350,000		445,000	
Recapping of Tires	....		50,000	
Dead Storage	....		5,000	
		$1,700,000		$1,100,000
Cost of Sales		1,421,200		936,100
Gross Margin		$ 278,800		$ 163,900
Expenses:				
Salaries of Executives	$ 17,000		$ 17,000	
Wages of Employees	117,300		70,380	
Rent	15,300		15,300	
Advertising	15,300		7,800	
Light and Heat	5,100		2,100	
Taxes	3,400		3,400	
Bad Debts	1,700		1,700	
All Other Expenses	83,300		45,000	
		258,400		162,680
Net Profit		$ 20,400		$ 1,220

* Including sales of parts, tires, and accessories.

floodlights and display lights. The budget for other expenses, such as insurance, taxes, transportation, telephone and telegraph, stationery and supplies, instruction and demonstration, warehousing and storage, and service under new car guarantees, was reduced from $83,300 to $45,000. In the light of the expected decrease in sales volume, all these reductions appeared to be reasonable.

Mr. Trevelyan was convinced that, so long as sales of new cars were banned, the service and repair department would be the chief source of revenue for the company. He argued that car owners would be increasingly conscious of the value of their cars and would

have them serviced more frequently than they ordinarily did. Accordingly he allotted to the service and repair department an additional 3,000 feet of space, bringing the total up to 8,000 square feet; and he purchased two new sets of lubricating equipment, two hydraulic hoists, and some additional bench tools. Most of this equipment was procured at second hand; but it was in good condition, and it cost the Trevelyan Motor Company only $2,000. The used car salesmen and the handy man assigned to the service department were sent to the Ford company school for instruction in the fundamentals of service and minor repairs. On their return, they were fully competent to work in the expanded service and repair department. Mr. Trevelyan secured a list of all owners of Ford-manufactured cars in his community and in adjacent suburbs as well, and to each he sent a circular describing a recommended service and conservation plan and calling attention to the facilities of the Trevelyan Motor Company.

In order further to add to the company's revenue, Mr. Trevelyan purchased two recapping machines and undertook to recap old tires with a so-called Victory Camelback. This Camelback was made entirely from reclaimed rubber, and Mr. Trevelyan believed that the supply of reclaimed rubber would remain unrestricted by the government since it lacked the durability required for military uses. Recapped tires were guaranteed for 5,000 miles, provided they were driven at reasonable speeds. The two men formerly classified as car washers were sent to the plant of a large tire manufacturer for instruction in recapping, and it was they who operated the new machines. When run at maximum speed by efficient men on a 24-hour basis, each machine had a capacity of 100 tires a day. The average output for a 24-hour day would be approximately 85 tires. In an 8-hour day, an efficient operator could turn out between 25 and 30 tires. The company's price of $5.50 for recapping a tire permitted a gross margin of 60% over the cost of materials. The recapping service was advertised to the public through newspapers, handbills distributed to a list of persons solicited for service and repair business, and large streamers in the windows of the showroom.

Another source of revenue which the company began to tap at this time was dead storage. Mr. Trevelyan believed that many motorists were going to want to store their cars for the duration, either because of the incidence of the Selective Service Act or because of the widespread conviction that rationing of tires and

gasoline would eventually prevent any civilian motoring whatsoever. With this in mind, he converted the unused part of his basement storeroom into a dead storage garage. The conversion was effected at a cost of $150 by cutting an additional door in the basement wall to conform to insurance regulations, laying a cement floor in the unused part of the basement, and installing wiring for lights. The converted section of the basement could accommodate 25 cars. Dead storage was advertised to the public at $5 a month, and within a week the available space was completely filled. Mr. Trevelyan proposed to expand his dead storage business as rapidly as he could dispose of the new cars which were stored in the basement.

Mr. Trevelyan was skeptical of the future of the used car business. He did not share the enthusiasm of those dealers who believed that the ban on sales of new cars would create a profitable boom in the used car business. On the contrary, he was of the opinion that the company would be fortunate in 1942 to equal its 1941 sales of used cars. He believed that the threatened limitations on driving would cause consumers to lose interest in owning automobiles, and he foresaw that the used car business would become so highly competitive that many dealers would sell undependable cars and thus destroy the customer confidence in used cars which it had taken the automobile trade so many years to establish. In short, he was firmly convinced that the used car department was not a division in which to place high hopes for increased revenue.

Mr. Trevelyan realized that income from sales of new cars would be drastically reduced. He was of the opinion, however, that by active solicitation the company could secure sales of approximately $150,000. Accordingly he assigned his two new car salesmen to canvass prime contractors, and he himself undertook the solicitation of local Army and Navy purchasing officials for sales of new cars.

Mr. Trevelyan believed that revenue from service and repairs, from recapping of tires, and from dead storage, added to sales of new and used cars, would be sufficient to meet the reduced expenses shown in his revised budget for 1942. But he wished to show some profit as well, and hence undertook to find a related product which might appropriately be offered by the Trevelyan Motor Company. At the meeting which he called early in January, he sought the opinion of his department managers on the advisability of accepting an agency for Safticycles, a new model of motor bicycles. He

argued that the restricted use of the automobile would cause people to look for other modes of private transportation and expressed the view that motor-driven bicycles would be one solution to the problem. He believed also that retail stores could advantageously use Safticycles for light deliveries.

The Safticycle was produced by a long-established manufacturer of a nationally known bicycle. It was advertised as designed and manufactured to exacting specifications. Every part was stated to have been carefully tested for durability. An aircraft-type steel tubing was used throughout; and the entire frame was welded into one piece, so that there were no bolts or rivets to work loose from road vibration. The 1942 models were equipped with a free-running automobile-type clutch with a single plate disc. The clutch and the brake were operated from a single pedal with either foot. The engine assembly, the V-belt drive, the clutch, and the brake were housed in, to keep out mud and water. The rear wheel sprocket was driven by a 3,000-pound-test Diamond Chain. The Safticycle was said to have low maintenance costs and low costs of operation. Users were reported to have achieved 140 miles per gallon of gasoline and a maximum speed of 35 miles per hour. Furthermore the Massachusetts insurance rates and registration fees[1] for motor bicycles were much lower than for automobiles. At the time, tires for the Safticycle were available and tire replacements could be made. Costs of garaging might be disregarded, since the Safticycle could be stored in the cellar or on the porch of a house.

The manufacturer offered the Safticycle to the Trevelyan Motor Company on an exclusive agency basis and agreed to furnish attractive floor displays and all necessary literature for the instruction of salesmen. The suggested retail price was $225, at which figure the gross margin would be 33⅓%.

What other action, if any, should the management of the Trevelyan Motor Company have taken in the effort to preserve the business?

[1] In Boston, for instance, the corresponding fees for insuring and registering a light passenger automobile and a Safticycle were as follows:

	Automobile	Safticycle
Personal Injury Liability Insurance	$53.70	$20.00
Property Damage Liability Insurance	23.00	11.50
Registration	3.00	1.50
	$79.70	$33.00

9. KNOWLSON COMPANY

ADJUSTMENT BY SPECIALTY WHOLESALER TO WARTIME CURTAILMENT OF PRODUCTION

In the early part of 1942, the president of the Knowlson Company, a full-function wholesaler of radios and electrical appliances, was considering the advisability of adding a line of occasional and novelty furniture. It was his thought that sales of this merchandise might compensate, in some measure, for the imminent loss of income from sales of radios and electrical appliances, production of which was being discontinued by government order.

The Knowlson Company had been founded in Boston, Massachusetts, in 1922 as a full-function wholesaler of radio parts and supplies. The company began operations on a small capital investment and grew with the industry. At the outset it handled only parts and supplies; but as the industry developed, radio receiving sets were added to the stock of goods handled. Subsequently the Knowlson Company had further extended its wholesaling operations to include refrigerators, washers, ironers, ranges (both gas and electric), vacuum cleaners, sun lamps, and miscellaneous items. By the year 1942 the company had become a well-known local distributor of radios and appliances and had achieved an annual sales volume of nearly $1,500,000. Its customers included primarily independent radio stores, radio and appliance stores, music stores, hardware stores, dry goods stores, and small department stores. The few large department stores and chains which purchased from the Knowlson Company were given the same terms as the company's other customers. The division of sales among the several types of merchandise and the percentage of gross margin on each in 1941 were roughly as follows:

Type of Merchandise	Sales	Gross Margin
Radios	$1,000,000	19.2%
Refrigerators	200,000	13.8
Washers and Ironers	250,000	17.6
Gas Ranges	8,500	21.6
Electric Ranges	6,500	18.4
Vacuum Cleaners	25,000	24.0
Sun Lamps	4,800	23.2
Miscellaneous	4,000	18.0

In this year the company realized a net profit of approximately 4% of sales.

For each manufacturer's line the Knowlson Company had exclusive distribution rights in the six Massachusetts counties which comprised its territory—Suffolk, Middlesex, Worcester, Essex, Norfolk, and Plymouth. The Knowlson Company employed eight salesmen, each of whom confined himself to a particular county or part of a county and sold the company's complete line of products. Semiannual quotas were established by product lines for each county or part of a county (that is, for each salesman) on the basis of figures from the Wholesale Census of Distribution. For sales within their quotas, salesmen were paid on a straight commission basis; for sales above their quotas they received a liberal bonus. The rate of commission was somewhat higher than the typical figure for the industry, since from their commissions salesmen were required personally to meet their traveling expenses. The distribution of territory and the compensation of the eight salesmen in 1941 were as shown in Exhibit 1.

EXHIBIT 1
KNOWLSON COMPANY
Salesmen's Territories and Total Compensation, Year Ending December 31, 1941

Salesman	Territory (County)	Compensation for Year
A	Suffolk	$7,250
B	Suffolk	6,000
C	Suffolk	5,300
D	Middlesex	4,200
E	Middlesex	5,700
F	Worcester	5,100
G	Essex	3,980
H	Norfolk and Plymouth	4,500

For the most part, the selection of retail dealers was left to the salesmen. If one dealer could produce the volume of sales which the Knowlson Company expected from the particular city or town, then that dealer ordinarily was granted exclusive distribution rights in his territory. But if no one dealer could bring in a large enough sales volume, the Knowlson Company sold to several dealers in the community. In 1941 the company made sales to 800 dealers

scattered throughout the six counties; but of the 800, only 400 were classified as active accounts, and 200 of these took more than 75% of the company's total volume. The smaller dealers received a 40% discount; the larger ones received 40% and 10%, and paid for their own advertising. Each salesman spent a part of his time helping dealers to solve their merchandising problems. By reason of this individual attention, the dealers felt themselves closely bound to the Knowlson Company; and the president of the company considered that his dealer organization was his greatest asset.

In the early part of 1942 the WPB order forbidding the manufacture of radios and appliances after May 31, 1942, threatened the continued existence both of the Knowlson Company's dealer organization and also of the company itself. Since the company's working capital was not large, its existing stocks were only large enough to sustain sales for approximately two months. Therefore, unless arrangements were made promptly for the addition of new lines of merchandise, there was a good chance that the company would find itself out of business by the middle of the summer.

Of the several types of merchandise which appeared to offer possibilities, the most suitable seemed to the president to be low-price occasional and novelty furniture, such as phonograph record cabinets, telephone stands, end tables, coffee tables, lamp tables, tier tables, smoking stands, folding chairs, towel racks, whatnots, bookcases, magazine racks, breakfast sets, and lawn furniture. He believed that the Knowlson Company could do an effective job in selling such furniture. He recognized that, although occasional and novelty furniture carried a percentage markup comparable to that on radios and electrical appliances, the dollar gross margin of the company would be much lower because the average unit sale would be smaller. He thought, however, that it would be possible to expand the salesforce and increase the number of dealers to an extent sufficient to maintain the total gross margin.

It was the opinion of the president that the problems involved in merchandising and distributing a line of occasional novelty furniture were not substantially different from the problems which his organization had encountered in wholesaling radios and other appliances.

Most of the dealers with whom the Knowlson Company was in contact were entirely without plans to meet the emergency and looked to wholesalers and distributors for help. The president of the Knowlson Company thought that most of his dealers were

capable of handling such furniture as he proposed to sell. These dealers included independent radio stores, radio appliance stores, music stores, hardware stores, and small department and dry goods stores. A majority of these dealers were thought to be able to finance a stock of occasional and novelty furniture. Also it was argued that such furniture would not occupy appreciably more space than radios in these stores. Most of these dealers were accustomed to selling on an exclusive basis. A majority of their sales transactions were made by outside salesmen, who canvassed prospects and followed up leads. The president of the Knowlson Company did not think that the purchase of furniture at such stores would be contrary to normal consumer buying habits.

A further reason for favoring the introduction of furniture to replace radios and electrical appliances was the president's belief that wartime controls were not likely to interfere seriously with the operations of the furniture industry. In New England in particular there were many small furniture and woodworking plants which had plenty of capacity and seemed assured of an ample supply of raw material.

Consequently the president instructed the salesmen of the Knowlson Company to spend some time seeking out furniture and woodworking manufacturers in their territories who might be in a position to produce items which the Knowlson Company could sell. He also asked the company's advertising agency to prepare a letter to be sent to all the furniture and woodworking plants in New England. The letter which the agency prepared read as follows:

GENTLEMEN:

Today it requires capital, distribution, and a completely established sales organization to merchandise a product or line of products effectively.

We have a client who has just these qualifications. They are one of the most successful distributors in the east and have nationwide connections.

Due to the war (priorities) this organization with their capital is available to a reliable manufacturer of consumer goods in nondefense materials. They are large enough to take the entire output of most any manufacturer. They are not interested in buying into your company. They will, however, supply any necessary cash needed for expansion or production.

To the right manufacturer they offer capital and nationwide distribution backed by 20 years of successful sales experience.

If you are interested, please give us a little information about your product and we will arrange an interview with our client at your convenience. If not interested, you may know of some manufacturer who would be, and you would be doing both them and our client a favor by advising us.

Very truly yours,

Believing that many small woodworking concerns did not have very effective sales organizations, the president of the Knowlson Company thought that it might be possible for his company eventually to serve as a selling organization for a group of these small manufacturing concerns.

Did the Knowlson Company have a sound program for meeting the emergency?

10. SILTON COMPANY

PROPOSAL TO PURCHASE NEW TYPE OF COUPLING

The Silton Company was a distributor of equipment for service stations, bulk tank stations, garages, heating oil distributors, oil burner dealers, and industrial plants. The company manufactured some items; but a majority it purchased from other manufacturers, many of them for sale under the Silton name. Among the products which it sold were gasoline and fuel oil hose and hose couplings. Early in 1936 the sales manager proposed that the company abandon the manufacture of Silton hose couplings for gasoline and oil hose and buy for resale a superior patented coupling made by the Kaylon Manufacturing Company.

The Silton coupling was an all-brass clincher type, made in one solid piece. The life of a coupling was longer than the life of the hose to which it was attached; but when it was installed, a coupling of this type could not be removed from the hose and used again. The Silton Company used two hydraulic presses to attach the coupling to the hose. It took one man 5 minutes to perform this job. The Silton Company purchased castings but completed in its own plant the final machining process on the coupling. The total cost of the Silton coupling, cast and machined ready for attaching to the hose, was 63 cents a set, of which somewhat less than 30 cents

was the cost of the machining operation. The selling price was 95 cents a set, and average annual sales of Silton couplings in the 3-year period 1933–1935 had been $20,000.

The coupling manufactured by the Kaylon Manufacturing Company was in three pieces. One man could easily install this type of coupling on hose by hand in approximately 5 minutes. The Kaylon coupling was readily detachable from worn-out hose and could be repaired or reinstalled on new hose in the field with only a hacksaw vise and a Stillson wrench.

The Kaylon Manufacturing Company did not sell hose and therefore was not a competitor of the Silton Company in the sales of finished hose with attached couplings. In 1936 a majority of concerns engaged in the hose business were using Kaylon couplings, and it was common practice for these manufacturers to advertise that detachable couplings were being furnished with their product. The Silton Company could purchase these couplings at 42 cents a set. The suggested resale price was 72 cents a set.

In defending his proposal to abandon the manufacture of the clincher type of coupling, the sales manager pointed out the superiority of the Kaylon coupling in use, its availability for attachment to new hose when the first hose was worn out, the ease of installation, and the lower cost. He added that, although the two hydraulic presses then being used for the installation of the Silton type of coupling would be idle a large part of the time, they had been fully depreciated and the change would not increase the company's overhead expense. The presses could be used occasionally for installing clincher couplings on outsizes of hose, for which three-piece couplings were not available.

Both the president and the treasurer disagreed with the sales manager. They stated that each replacement of a hose equipped with Silton couplings required the purchase of new couplings. The Kaylon coupling, however, would not be limited in service to the life of the original piece of hose. Because of this fact and also because the selling price of the Kaylon coupling was lower than that of the Silton, the president thought that a shift from Silton to Kaylon couplings would result in at least a 50% decline in dollar sales of hose couplings. The president further argued that the sales of hose might be affected adversely by the use of Kaylon couplings. He pointed out that the customer did not have the necessary equipment for attaching Silton couplings and therefore

was forced to buy hose and couplings from the same source. Since the Kaylon coupling could be readily attached by the customer, there might be a tendency to purchase hose and couplings from different sources. Finally, the treasurer added, although the hydraulic presses had been fully depreciated, they were still in good condition and available for use.

Should the sales manager's proposal to buy Kaylon couplings have been adopted?

11. MILTIADES PAPER COMPANY

INTRODUCTION OF NEW TYPE OF PAPER

In February, 1934, the management of the Miltiades Paper Company approached a marketing consultant for advice regarding the merchandising of a new type of paper, called Easyrase Bond, which it had started to manufacture some months before. The company owned a small mill in upper New York state with a daily capacity of approximately 25 tons. Although the management had found that typists liked the new paper and expressed a preference for it, sales had been disappointingly small.

Easyrase Bond permitted unusual ease in erasure of typewriting. A light rubbing with a pencil eraser completely removed typing ink. Nevertheless, the paper was suitable for records by virtue of the fact that within 12 hours the typewriter ink was absorbed into the fiber of the paper, making erasures almost as difficult as on ordinary paper.

Easyrase Bond was the result of a newly patented process of coating paper with a certain material. Because of this extra process, the company had found it necessary to charge 4 cents a pound more at the mill for this paper than for ordinary bond paper of similar weight and rag content. At the time, the prevailing mill price for bond paper containing 25% rag was 12 cents a pound, while the mill price for Easyrase Bond was set at 16 cents. With a considerable increase in tonnage produced, the price differential could be cut to 2 cents a pound; and a further cut in price could be made by reducing the rag content. A 10% rag-content paper surfaced with the new material gave a feel and appearance equiv-

alent to those of a 25% rag-content bond and could be sold at the same price as an ordinary 25% rag-content bond, provided volume was large. Since a 10% rag-content bond was not recognized by the American Writing Paper Association as a standard grade, however, the Miltiades Paper Company could not sell it as a rag-content paper. But there was some question whether it might not be advisable to drop all rag content and go over to a straight sulphite bond because the appearance and feel of a sulphite bond and of a rag bond when coated with the Easyrase material were much the same. A first-grade all-sulphite bond could be produced for about 8 cents a pound, and to this would be added the cost of coating the paper with the erasable material.

During the depression years 1930–1934 there had been a tendency for business firms to buy cheaper grades of letterhead paper than in the preceding period. Even before the depression, a large majority of letterheads had been printed on sulphite paper; but the managements of many business concerns had purchased rag papers because of their superior surface, appearance, and durability. It had been the opinion of these executives that high-grade direct-mail advertising pieces and important letters printed on rag-content bond made a more favorable impression on the receivers than letters written on sulphite papers. Accordingly, rag papers had enjoyed a market prestige and had commanded a better price than sulphite papers. During the 1920's it had been not uncommon for some companies to use even a 50% rag-content bond. But during the depression the market for such high-grade paper had materially decreased, and the demand had shifted to lower grades. In 1934, among rag papers the greatest demand was for 25% rag-content bond, which wholesalers sold for 21 cents a pound. Many pre-depression users of rag paper had turned to first-grade sulphite paper, which at this time was available to quantity users from paper wholesalers at approximately 11 cents a pound. Small-lot buyers paid from 1 cent to 4 cents a pound more.

Wholesalers' prices for Easyrase Bond of 25% rag content were in the vicinity of 28 cents to 30 cents a pound. The Miltiades Paper Company had induced several jobbers and lithographing and printing firms which specialized in letterheads to carry Easyrase Bond. Although these paper wholesalers and printing firms were enthusiastic about its qualities, they had failed to sell it in considerable quantities. They reported that stenographers almost

invariably liked the paper; the easy erasure resulted in time saving and permitted neat work because the texture of the paper was not marred. Purchasing agents, however, did not appear to be greatly influenced by the preferences of stenographers. They seemed to be guided by a desire to obtain a good-looking paper at the lowest price possible. Although ease of erasing was one of the qualities looked for in papers and had been stressed by paper manufacturers, the purchasing agents apparently were not willing to pay a price differential for this characteristic.

Amateur typists, who made more erasures than did trained stenographers, were found to be particularly enthusiastic about the new paper when its advantages were called to their attention. While the so-called amateur typists' market was small as compared with the industrial market, it was of some consequence, particularly among college students. The prices charged by retail stationers in 1934 for a ream of various bond papers of standard size, 8½ by 11 inches, were approximately as follows:

Easyrase Bond	\$1.50–\$1.75
25% Rag-content Bond	1.00– 1.25
First-grade Sulphite Bond	\$0.75

A limited survey among users indicated minor difficulties with the paper. If a too heavily inked typewriter ribbon was used, there was a tendency for the paper to smudge. This difficulty was entirely obviated, however, when a normally inked ribbon was used. Moreover, some buyers did not like the appearance of the paper, which was made distinctive by the surfacing material, but others expressed a preference for the finish.

When executives of the Miltiades company approached the marketing consultant, little thought had been given to special packaging of Easyrase Bond. The paper was made available only in reams, and the package did not tell the story of the erasable qualities. In addition, amateur typists, wanting small quantities, had to ask the dealer to break a ream.

Up to this time Easyrase Bond had not been advertised either to paper users or to the trade; the company had relied on its small salesforce, the jobbers, and the letterhead specialists to spread the story of the new paper. Since the jobbers handled the papers of a number of manufacturers and sold many sizes, grades, and colors, they could not be depended on to devote any considerable

effort to the promotion of the new paper. One of the letterhead companies which had become enthusiastic about Easyrase Bond had sold larger quantities than any other customer, stating that the novelty of the paper gave salesmen a good means for catching the attention and interest of customers. Even though they might not sell the new Easyrase Bond, they were given an opportunity through it to present other items in the line.

The channels of distribution for paper of this kind were not clear cut. Some business organizations bought several tons of such paper at a time from paper jobbers and had their letterheads printed. Other industrial buyers purchased their letterheads through printers or lithographers, who, if large, bought some of their requirements from the mill, although a great majority of printers purchased from paper jobbers. Amateur typists ordinarily bought their paper from stationers, who, in turn, secured their supplies from paper jobbers. The Miltiades Paper Company's sales were for the most part limited to paper jobbers, although some sales were made direct to a few large printers of letterheads.

The company employed a salesforce of five men, who traveled as far west as Chicago. In addition to working with selected paper wholesalers who handled the company's products, these men devoted part of their time to missionary work among large buyers of paper, such as printers and the purchasing agents and office managers of large industrial organizations.

What recommendations should the marketing consultant have made for the merchandising of the new Easyrase Bond?

12. FILTON MACHINERY COMPANY

SELECTION OF LINES OF MACHINERY TO BE HANDLED

The Filton Machinery Company was a distributor for about 20 lines of machine tools, for most of which it had exclusive agencies. The company had been in operation for many years and had a reputation for reliability. Its annual sales volume was approximately $1,000,000. During 1927 and 1928, the company was offered exclusive agencies for several well-known lines of machines.

The machine tools which the Filton Machinery Company sold were used for grinding, boring, drilling, shaping, planing, and

milling. The company sold to dozens of different industries; among its chief types of customers were shipbuilders and manufacturers of automobile bodies, railroad cars and equipment, textile machines, electrical equipment, and candy machines. The tools ranged in price from $100 each to $35,000 each; but the greater proportion of sales were of machines priced at $5,000 to $10,000 each. The discounts received by the Filton Machinery Company from the machine manufacturers amounted to between 10% and 12½%.

The company employed four salesmen, who were paid straight salaries. They kept in contact with approximately 1,000 customers, who were located within about 100 miles of the large industrial city where the company had its office. Each customer was called on from six to twelve times a year except when he was actively in the market, under which circumstances more frequent calls were made. Most orders received were for one to three machines.

The company's salesmen had no formal engineering training, but three of them had had experience in machine shops. Most of the lines carried by the Filton Machinery Company were of standard design and were used for purposes familiar to men with mechanical training. The manufacturers of the machine tools usually furnished such engineering service as was required in making special applications of standard equipment. When a new type of machine was introduced, the manufacturer customarily sent a man to demonstrate the machines to purchasers after installation.

In 1927 the Rhone Company offered the Filton Machinery Company an exclusive agency for its line of molding machines, which sold at prices ranging from $200 to several thousand dollars. These machines were of high quality and were well known. The Filton Machinery Company, however, decided not to sell the Rhone machines. Those machines were used in iron and steel foundries, whereas the machines already marketed by the Filton Machinery Company were used for metal-working purposes in machine shops. The company had no contact with foundries, except in cases where its customers also operated foundries in addition to machine shops; the company estimated that about 5% of its customers had foundries.

The Filton Machinery Company also was offered an exclusive agency for a reliable line of light-duty grinders selling at $1,900 each. This line at the time was handled by several agents in

the city in which the Filton Machinery Company was located. The company already was selling a line of heavy-duty grinders at prices ranging from $2,900 to $20,000. The light grinders and the line of heavy grinders were not strictly competitive; the former machines were best adapted for producing 15 to 25 pieces per given time unit, and the heavier machines were more economical for larger quantity production.

The Filton Machinery Company agreed to represent the manufacturer of the light grinders but refused to accept an exclusive agency for the line. The president of the company stated that if the company held the exclusive agency it would be expected to promote actively the sales of the light machines; such action might interfere not only with sales of the heavy grinders but also with the interests of the company's customers. Although the two lines of machines were not strictly competitive, the president believed that there would be a tendency for the salesmen to recommend the lighter and cheaper machines in order to make a sale, even though those machines were not best suited to the customers' purposes. The president was of the opinion, moreover, that if the company merely represented the manufacturer of lighter machines along with several other representatives in the same territory, there would be no likelihood that the Filton salesmen would sell those machines when it was not to the best interest of the customers.

The Filton Machinery Company later was offered an exclusive agency for a line of power and hand scrapers which were used in metal working. The same type of customers to whom the company already sold also had use for scrapers. The power scrapers were priced above $800 each, but the hand scrapers sold at approximately $10. The company could not have the agency unless it handled both types of scrapers. The president, however, believed that the low-price tools should be sold through specialty equipment firms. The volume of sales of hand scrapers would be small; and those tools could be sold by low-salaried salesmen. The company might have considered adding a power scraper to its line, but the president was convinced that it would be inadvisable to accept the offer as made.

Did the Filton Machinery Company make sound decisions with respect to these several lines of machinery?

13. LAPOINTE MACHINE TOOL COMPANY

INTRODUCTION OF NEW MODEL

Early in 1940 the management of the Lapointe Machine Tool Company faced the problem of introducing and promoting a new "streamlined" model of broaching machine, designated as type "HP" (see Exhibit 1). This model had been developed in 1939 to be shown at the Cleveland Machine Tool Show in October. Because of the outbreak of war, the show was canceled. The

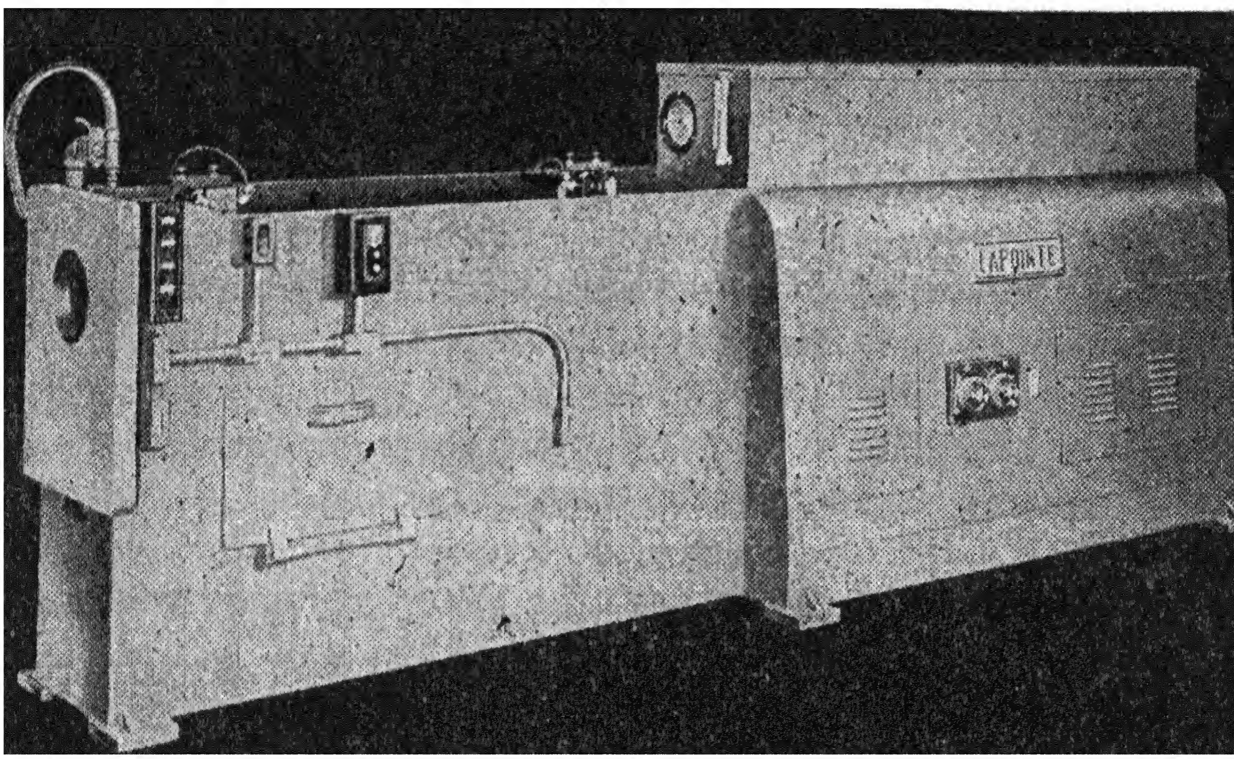

EXHIBIT 1.—Lapointe Machine Tool Company. Type HP-30, horizontal hydraulic broaching machine. (Capacity, 15 tons; stroke, 52 inches.)

increased pressure of armament demand since that time had also caused the company to question the timeliness of promoting the new type of machine.

In the spring of 1940 the management was withholding aggressive promotion of the new model and had still not formally introduced it to the trade. Although the new type had not been advertised in the trade journals, salesmen were carrying a full description and were permitted to quote prices on a few sizes. The new machine, in the size which had been selected for initial development, sold at $4,500, whereas the comparable machine in the old style sold at $3,600. The new model did not speed up the actual broaching operation.[1]

[1] *Broaching* consists of drawing a long, tapered tool through a piece of metal or,

The Lapointe Machine Tool Company, located at Hudson, Massachusetts, was the oldest and largest producer of broaching machines and broaching tools in the country. The company specialized entirely in broaching equipment. Horizontal-pull broaching machines, such as the new HP type and the older L style (see Exhibit 2), were produced in seven sizes ranging from 7½ to 50 tons drawing power. The new HP type was first developed only in the 15-ton model, which was the most popular size. The designing had since been completed on two other sizes, the

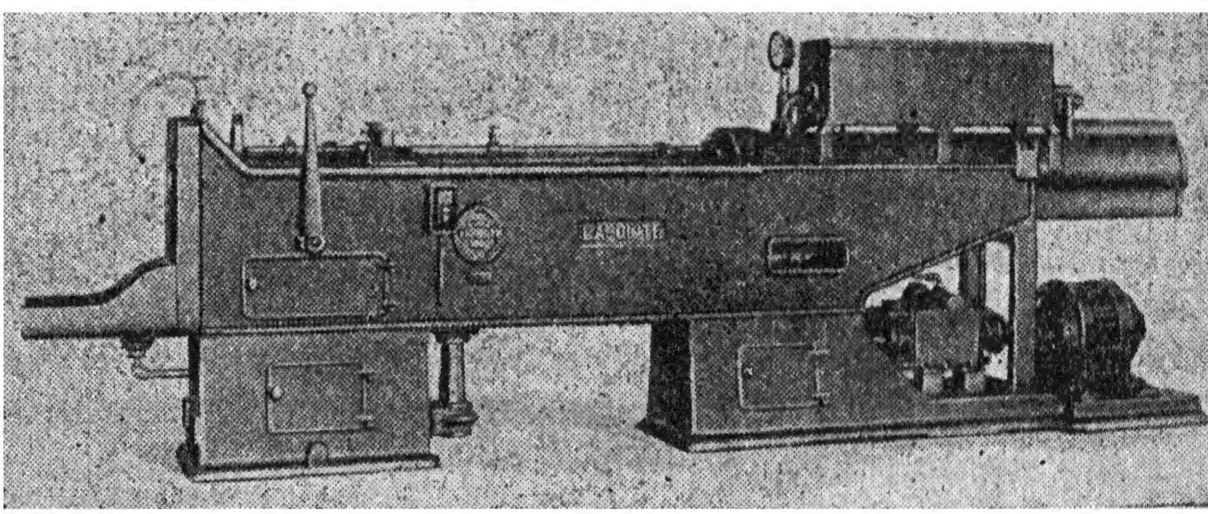

EXHIBIT 2.—Lapointe Machine Tool Company. Type 3-L-8, standard horizontal hydraulic broaching machine. (Maximum length of broach that can be used, 68 inches; cutting speed variable, 20 F.P.M.; return speed variable, 100 F.P.M.)

25- and 50-ton machines, which could be produced and sold immediately if desired. Engineering work was in different stages of completion on other sizes. The company was not considering discontinuance of the old style in any of these sizes.

Lapointe broaching machines and tools were used in a wide variety of industries. Almost all companies manufacturing machinery or engaged in complex fabrication of metal parts required broaching operations at various stages. During normal times the automobile industry had been the largest user of Lapointe products. By early 1940 the greater part of the company's output

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in the case of external broaching, across the surface. The tool has a series of teeth, each of which takes out a small quantity of metal, so that when the broaching stroke is completed, the desired shape has been cut into the metal. The broaching machine is the heavy power-driven mechanism which forces the tool through the piece being cut. Broaching is the most practical method of cutting certain irregular shapes in the interior of metal pieces in large quantities. Cuts into very hard metallic parts, such as the splines on the inside of an airplane propeller hub, can be machined in this manner.

was going to industries participating in the armament program. Operations were at capacity level, and orders were booked for many months in advance.

The new-style machine had been under consideration for more than a year. The actual decision in 1939 to go through with the development of the new model was prompted by the coming Cleveland Machine Tool Show planned for October, 1939. The executives wanted the new model ready in order that they might have something more recent to exhibit than the same old model which had appeared in the 1935 show. The old model had been steadily improved in mechanism but had not changed in basic appearance since 1924. The hydraulic-operated mechanism in the new HP style was essentially the same as in the old model. The new features were a radically changed appearance and push-button electric controls (see Exhibit 1).

The satisfactory functioning of the HP model with the recently developed push-button electric controls was important because the Lapointe company valued highly the reputation of its equipment and was unwilling to promote any products which had not been thoroughly tested and proved. The officers in charge of sales promotion decided that the best way to introduce the new model would be to place it in the plants of about 10 or 12 selected customers with whom close relations had been established. The functioning of these machines could then be closely watched, and any troubles ironed out without impairing goodwill or product reputation. The strength of the demand for such modernized equipment made it doubtful, however, whether sales could be confined to selected customers once the machines were definitely announced as being available.

The company was represented by a salesforce of six men located in various industrial centers throughout the country. In other areas, where the demand was not heavy enough to support one of the company's own salesmen, the line was handled by agents who also sold other noncompeting machine tools. The greater part of the company's sales came through the direct sales efforts of its own salesmen. The company advertised its lines in the leading trade journals, and it was well known to a majority of purchasing agents in plants where heavy machine tools of this type were used. Many inquiries came direct to the company's head office and were turned over to the district salesmen. The company also had in

England a sales agent and a small plant for producing broaching tools only.

The company's executives anticipated a 1940 sales volume of about $1,500,000. Sales were on a one-price basis, and the trade-in allowance on old equipment was fairly standardized. During 1939 about 75 of the old-style machines of 15-ton capacity had been sold, and a total of over 500 machines of this particular size were in use in various plants. Broaching machines seldom wore out, and they had an almost unlimited operating life. Broaching tools, on the other hand, required frequent replacement and therefore provided a more stable sales outlet than the machines. During normal times, tools accounted for over half the company's sales volume.

The broaching machines produced by the company were heavy and complicated, and were manufactured only on special order even though they were standardized in construction. A small inventory of some parts was carried. Each broaching tool was individually designed and required long and elaborate drafting. The production of the completed tool was a job calling for a very high degree of precision and most painstaking workmanship. Tools used in the new type of machine would not be changed in any way. All parts of the old-type machine were manufactured in the company's own plant; but several units of the new model, including the electric control mechanism, had to be purchased from other manufacturers.

Production of the HP model with automatic controls had been made possible by the recent development of solenoid-operated valves. Solenoid operation of valves utilized a magnetic impulse induced by electric current controlled by the operator's switch in order to throw the valve mechanism. This type of control system had been developed and made available in satisfactory form only within the past two years. On the old model, the valve control was operated by a hand lever on the side of the machine. The physical effort required to move the control lever on the old type was small, but of course merely pushing a button was easier and simpler.

In recent years there had been a decided trend toward push-button controls and modernized appearance of machine tools. Another machine tool manufacturer in a near-by community had put electric controls and a modernized metal jacket on one of the standard machines which the company had been making for a

great many years. The price of this revamped machine had been sharply increased, and there had been no change in its rate of operation. Nevertheless, this manufacturer had experienced very satisfactory sales of the new product. At the time when development of the streamlined broaching machine was under consideration, there were no similarly modernized, directly competing machines on the market. The management did know that one of the company's competitors was also working on a modernized model. The Lapointe salesmen were eager to have the new type developed and had been asking for it. Many customers had also been inquiring as to when the company would have equipment of the new modernized style.

The salesforce maintained that the streamlined machine had many sales advantages to offset its higher price. They believed that, apart from the cold logic of relative efficiency, the modernized model offered something new and different which the customers wanted. It had been noted that other manufacturers were having considerable success in inducing customers to trade-in their old-fashioned manually operated machine tools for the new, more attractive electric-control types. The company had found that it could take old-model broaching machines of the 15-ton size in trade at around \$700 to \$800, overhaul them completely, and find a ready market at a price which compensated for overhaul and sales effort. The overhauled machines were sold with a new-machine guarantee. The company salesmen believed that they could replace a number of the old machines by taking them in trade on the new model at trade-in prices satisfactory to the company. The salesmen also thought that the new model would give them real competitive advantages and help them maintain and expand the company's market.

The new type of machine was much more attractive in appearance than the old model. Many of the company's customers were found to be stressing eye appeal in their plants and were developing considerable pride in the interior appearance. In particular, some of the large automobile plants and aircraft companies preferred attractive, modern-appearing equipment when such could be obtained; and they seemed to be willing to pay a premium for these qualities. In addition, many other companies which were expanding to meet the foreign and domestic armament demand were found to be interested in obtaining equipment of the modern, attractive

type. The customer's keen emphasis upon minimum price and maximum output per dollar of plant investment, which had characterized the decade up to 1939, was apparently disappearing.

Workers also preferred modern push-button-controlled equipment, in which the moderate physical exertion required to move the old-type control lever was eliminated. The simplicity and ease of operation appealed to them. The new, solidly encased machinery was also much easier to keep neat and clean. Installation of modernized equipment was believed sometimes to help in the improvement of labor relations. Instances had been reported in which organized workers actually had refused to use old-style machinery, thus forcing companies to obtain new equipment. The Lapointe officers were inclined, however, to discount the overall importance of this latter influence, particularly in view of the changing attitude toward productivity resulting from the National Defense emergency.

The officers of the Lapointe company had also heard reports indicating that somewhat higher production could sometimes be obtained from the new electrically controlled type of equipment, even though the rate of output of the new machinery was theoretically the same as the old. The reason advanced for this increase in production was that the workers took greater pride in the new attractive equipment, liked to operate it, and therefore worked better. One of the company's customers, in discussing his firm's interest in the new model, mentioned that he had run tests on somewhat similar equipment, alternating workers between the old-style manually operated machines and the modernized electrically controlled machines. For no apparently logical reason, the men working on the new type consistently showed a 10% to 15% higher output. The general manager of the Lapointe company, however, did not think that such experiences would necessarily prove to be the rule.

The vice president in charge of production reminded some of the advocates of the new model that the company had several balancing considerations to weigh. In the first place, the profit on the new machine was slightly lower than on the old, despite the $900 differential in price. This disadvantage in profit resulted primarily from the necessity of purchasing many parts from other manufacturers, whereas the Lapointe company itself manufactured all the parts of the old machine. The solenoid-operated valve

system had to be obtained in entirety from outside and could not be produced by the company. The possibility was admitted, however, that with further development the cost of the new model could be brought down appreciably and a margin of profit obtained which would be comparable with that on the old machine.

The vice president also suggested that promotion of the new model might well be held in abeyance because of the urgencies of the National Defense program. There was a heavy demand for Lapointe machines and tools, many of which were important for armament production. The company delivered equipment both to government arsenals direct and to other manufacturers producing for the government and therefore anticipated even heavier pressure for rapid output over the period immediately ahead. The old-style machine was easier for the company to manufacture and could be turned out more rapidly than the new model. Production would thus be simplified and speeded up by concentration on the one model, rather than attempting to make a large number of both the new and the old types in the various sizes.

Several advocates of the new-style equipment stressed the fact that the strong demand for the company's products at that time afforded a favorable opportunity to launch the promotion of the HP model broaching machine. The vice president considered that this view had merit in the light of 1939 conditions but that the greater urgency and increased tempo of the 1940 situation had since made the armament demand a reason for deferring aggressive promotion.

Should the Lapointe Machine Tool Company have undertaken actively to promote this new model in 1940?

14. DEWEY & ALMY CHEMICAL COMPANY (B)

DETERMINATION OF PRODUCT POLICY IN LIGHT OF RAW MATERIAL SHORTAGE

In June, 1941, executives of the Dewey & Almy Chemical Company, faced with curtailment of the supply of rubber by order of the OPM,[1] considered what steps should be taken with reference

[1] General Preference Order No. M-15, effective on June 20, 1941, cited the uncertainty of future shipments of rubber from abroad as threatening the requirements of

to the manufacture of the innersoles which it marketed under the brand name "Darex."

The Dewey & Almy Chemical Company had been founded in Cambridge, Massachusetts, in 1919 to develop products based on research in colloidal chemistry. By 1941 it was manufacturing a wide variety of high-quality articles, with total annual sales of approximately $7,000,000. The organization comprised five different product groups, as follows: (1) canning, (2) Cry-O-Vac, (3) cement, (4) balloons and specialty products, and (5) shoe products.

The shoe products division, which manufactured innersoles, outer soles, sock lining, cement, and welting, was one of the most important divisions of the company. Dewey & Almy shoe products were bought by approximately 300 shoe manufacturers throughout the United States. Practically all these manufacturers used at least two of the items, and several used all. Sales were made in the northeastern states by the company's regular salesforce; in shoe manufacturing centers elsewhere, by manufacturers' selling agents.

Darex innersoles contributed somewhat over one-third of the sales volume of the shoe products division, and indirectly another one-sixth in sales of products, including sock lining and welting, which could not be manufactured unless innersoles were produced also. Although the gross margin on Darex innersoles was somewhat less than the average of the division, a higher margin on the additional one-sixth brought the margin for this group of products up to a satisfactory level, equivalent to the division's average.

Innersoles were a necessity for the manufacture of practically all shoes. Makers of the highest-grade shoes used leather innersoles. In medium-price brackets there was wide use of innersoles made from various rubber-impregnated felts. In very cheap shoes the innersoles sometimes were made of treated cardboard.

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the national defense program for rubber and products of which rubber was a component, unless the existing and future supply were conserved and the existing and future use and distribution directed.

Accordingly, during each month of the second half of the calendar year 1941, processors were required to limit their total consumption or processing of rubber, from whatever source obtained, to an amount not exceeding a stipulated percentage of the average monthly consumption during the 12-month period ended March 31, 1941. The specified percentages were as follows:

July	99%	October	84%
August	94	November	82
September	89	December	80

Subsequent limitation orders on rubber were much more drastic.

Darex innersoles were made of compressed felt impregnated with latex. Rigorous tests had shown that these innersoles were little affected by perspiration, that they held their shape, and that they wore almost as well as leather innersoles. Their principal application was in the manufacture of women's novelty shoes; and of the innersoles of this type used in such shoes in the United States, more than 20% bore the Darex brand name. Darex innersoles were manufactured in three grades:

Grade	Price per Pair	Percentage of Total Dollar Sales of Darex Innersoles	Range of Retail Prices of Finished Shoes
A	2.6¢	50%	\$5.00–\$7.50
B	1.7	26	3.00– 5.00
C	1.4	24	1.98– 3.00

Competition among manufacturers of innersoles was keen. Innersoles similar to the Darex product were manufactured by five other companies. The distribution of dollar sales of this type of innersole among the several competitors was roughly as follows:

Dewey & Almy	20%
Company A	20
Company B	20
Company C	20
Company D	10
Company E	10

Companies A, B, and C were large and financially sound; D and E were small organizations.

Company executives believed the Darex innersole to be one of the most widely known of all Dewey & Almy products; hence any development which threatened the continued manufacture and sale of Darex innersoles was looked upon as a threat to the company's position of leadership. Nevertheless, executives recognized that OPM Order M-15, curtailing the quantity of rubber which might be processed, was unquestionably only the first of a series of such orders and that sooner or later the available supply of rubber would be very drastically reduced, if not entirely cut off. Accordingly consideration was given to the importance of reviewing each product line throughout the company with an eye

to the possibility of simplification, to the discontinuance of unprofitable items carried solely for competitive purposes, and to the simplification of such items as were retained, through elimination of unnecessary minor variations. The executives were agreed that the rubber allocated by the OPM order should be used where it was most important. The sales manager suggested also that means be developed for measuring controllable profit in terms of rubber consumed, so that, other considerations being equal, the available supply of rubber might be allocated to the articles with the highest controllable profit. The computation which the sales manager proposed for measuring controllable profit in terms of rubber consumed employed the following data:

Item	Innersoles	Outer Soles	Sock Lining	Cement	Welting
Unit	Sq. Yd.	Pair	50-in. Yd.	Gallon	1,000 Yd.
Selling Price per Unit	$0.42	$0.75	$0.35	$2.10	$4.75
Cost per Unit*	$0.37	$0.72	$0.33	$1.35	$3.35
Controllable Profit per Unit	$0.05	$0.03	$0.02	$0.75	$1.40
Estimated Sales in Units	600,000	80,000	60,000	200,000	12,000
Rubber Consumed per Unit	½ lb.	1 lb.	⅕ lb.	3 lb.	4 lb.
Controllable Profit per Pound of Rubber	$0.10	$0.03	$0.10	$0.25	$0.35
Number of Pairs of Shoes per Unit of Product	28	1	40	1,000	1,000
Controllable Profit per Pair of Shoes	$0.0018	$0.03	$0.0005	$0.00075	$0.0014

* Including share of factory and administrative overhead.

In view of the rubber shortage, it was a foregone conclusion that the manufacture of outer soles would have to be dropped entirely. Sales of welting could not be expanded appreciably without cutting prices to such an extent that the controllable profit per pound of rubber would probably fall to a lower level than that realized on innersole material. So far as Darex innersoles were concerned, the sales manager pointed out that the product might be eliminated for the duration of the rubber shortage, or continued with substantial modification of the rubber content, or manufactured solely on a synthetic basis if sufficient supplies of synthetics became available.

If the product were discontinued, there would be a considerable release of rubber for other lines within the division. Although a

single pair of Darex innersoles contained only about 2/100 of 1 pound of rubber, sales were of such volume that the annual output required approximately 150 tons of rubber. Furthermore, in terms of controllable profit per pound of rubber, Darex innersoles measured less favorably than cement and welting. On the other hand, innersoles were essential to shoes; and it was known that most of the manufacturers who used Darex innersoles used also one or more of the other Dewey & Almy shoe products. Hence discontinuance of the Darex innersoles might affect the sales volume of other shoe products as well. Also there was the danger that if the company ceased to manufacture Darex innersoles it might have difficulty later in regaining its position in the market, since existing customers presumably would have formed the habit of purchasing from other suppliers, all of whom were struggling with much the same problems as those faced by the Dewey & Almy company.

The potential shortage of leather, as well as its high cost, meant that relatively few shoe manufacturers would find themselves in a position to substitute leather innersoles for products of the Darex type. The quality of the Darex innersole was in some degree dependent on the density of the latex solution used for impregnating the compressed felt. Hence a reduction in the use of rubber would result in a somewhat less satisfactory product. At least one competitor of Dewey & Almy was known to have lowered the quality of his innersole and to have refrained from informing his customers of the change. One possibility which presented itself was to make the impregnating solution of a blend of latex and a synthetic material already developed in the Dewey & Almy laboratories. Just enough of this synthetic material was being produced to permit maintaining the volume of innersole production while effecting a 25% saving in the quantity of rubber used for the Darex innersoles. The cost of producing the innersoles would be increased slightly, but the company need not advance the price of the product if it was prepared to absorb a very slight reduction in margin. The same blend of latex and synthetic material could be used in manufacturing sock lining and welting, but not shoe cement.

There was a possibility of eventually making the impregnating solution without any rubber whatsoever. An innersole made from this synthetic could probably be used satisfactorily, and the resulting product would probably meet all the tests to which the latex innersole was submitted, save one—that of high temperature. When

exposed to the heat of the steam machine used by a majority of shoe manufacturers, the synthetic material was likely to soften and buckle. Hence if this material were used without any rubber, shoe manufacturers would have to be warned and asked to cooperate in meeting the problem. In this event the company presumably would continue to manufacture the innersoles in Grades A and B, but would abandon Grade C since innersoles made with the synthetic material alone in this grade would not wear well. Prices of Grades A and B would have to be advanced to 2.8 cents and 1.9 cents per pair, respectively, because of higher costs. It was estimated that enough production of the synthetic material to make this program possible might be achieved in about six months.

The Dewey & Almy management thought that the new synthetic material would be fully as good as anything on the market six months hence, if not better, and that it would give satisfaction, provided shoe manufacturers changed their manufacturing methods slightly to avoid exposing these innersoles to high temperatures.

In case the manufacture of Darex innersoles was continued under either of the alternatives indicated, there was a problem of policy with respect to the Darex name. On the company's existing innersole product, the name Darex was stamped in black at frequent intervals. Although the executives thought that substantial goodwill attached to this name, opinions differed as to how this goodwill could best be protected. One view was that the value of the name ought not to be diluted by any use whatsoever on an inferior product. In opposition to this view it was urged that the name Darex ought to be kept prominently before the market, since after any lapse in its use there might be difficulty in reestablishing it in the minds of the shoe trade. In support of this contention it was pointed out that all other producers of innersoles were in a similar situation, that quality was inevitably going to be lowered all the way round, that shoe manufacturers would have practically no option of buying superior innersoles, and that the quality of Dewey & Almy's product on a relative basis would be as good as ever. A compromise proposal was that the change in the character of the product be indicated by stamping the name Darex in brown instead of in black.

What policy should Dewey & Almy have followed with respect to Darex innersoles?

15. FOLSOM PUMP COMPANY

NEGOTIATIONS FOR MORE LIBERAL GOVERNMENT SPECIFICATIONS

In the summer of 1940 the assistant sales manager of the Folsom Pump Company recommended to the director of sales that the company make a strong effort to demonstrate to purchasing officers of the United States Army and Navy the desirability of rewriting specifications for gasoline pumps, air compressors, and similar equipment. The rigidity of specification clauses and the adherence of the purchasing departments to specifications that the company's officers regarded as outmoded had effectively barred the company for more than ten years from bidding on and securing any substantial volume of military business. The assistant sales manager cited recent correspondence between the company and the U.S. Department of Agriculture concerning air compressor specifications as evidence that revision of specification clauses might be secured through a proper approach.

The Folsom Pump Company was one of the largest manufacturers of self-measuring gasoline pumps, tanks, air compressors, and similar equipment. Its products were sold primarily to the major oil companies. During 1917 and 1918 the company had been a large supplier of gasoline pumping equipment to the Army and Navy. In the years following 1920 the company's military business had declined. Army and Navy purchasing was, of course, substantially reduced at that time; but, in addition, the company was unable to submit bids on most military contracts for its type of equipment because of the way in which specifications were written. The company's officers stated that after 1920, when contracts for pumping equipment were offered, the specifications were written largely in terms of the product of one or another single manufacturer; that is, they were not written in such general terms that several manufacturers might bid on any one contract with a hope of securing the contract.

In the opinion of the executives of the Folsom Pump Company, this condition was partly the result of the practice of many manufacturers of maintaining Washington representatives, who spent most of their time with government purchasing officials and were influential in advising on the writing of specifications. In part, too, the difficulty encountered by the Folsom Pump Company

was the result of the continued use of specifications for pumping equipment which the company's executives regarded as outmoded. In many instances the company no longer manufactured the specified type of equipment, the executives preferring to concentrate on more modern and improved varieties of gasoline pumps, tanks, and air compressors.

From time to time it had been suggested that the company maintain its own Washington office and, through contact with government purchasing departments, exert some pressure toward the writing of specifications in such terms that the Folsom Pump Company might bid on contracts with hope of success. The small volume of government orders to be filled during the 1920's and 1930's, however, and the expense of maintaining representation in Washington discouraged the executives of the company from attempting to exert influence in this way. Similar difficulties with specifications from the Federal government had been experienced in the company's various branch offices, which, on the other hand, were able to submit bids on some contracts from local governments.

In the summer of 1940 the Folsom Pump Company was securing practically no government business. At that time the factory was not producing at or near capacity. The company was employing approximately 1,300 workers in its main plant on the basis of one shift and a 40-hour week. Many of the company's major executives, who remembered the company's experience with orders from the Army and the Navy in the 1920's and 1930's, were not anxious to increase the volume of military business. Believing that many military specifications were for outmoded equipment, they felt no enthusiasm for the handling of orders of this type; and at least two of the officers expressed their dissatisfaction at the continuance of the practice of writing certain specifications in such terms that only one or two companies could submit bids.

At this time the assistant sales manager brought to the attention of the sales director correspondence between his office and the Chairman of the Technical Advisory Board of the U.S. Department of Agriculture. He stated that the correspondence aroused some hope that a similar line of development might be opened with Army and Navy purchasing boards, so that liberalization of existing specifications might be worked out. It was possible that this liberalizing move might be in the direction of securing industry-wide cooperation in the development of new specifications. With

new specifications, the government in its various departments not only might obtain the newest developments in pumping equipment but also might expect competitive bidding from all the major producers in the field and, as a result, lower prices than formerly from the successful bidders. In submitting the correspondence for the consideration of the director of sales, the assistant sales manager added that it would be to the immediate advantage of the Folsom Pump Company to secure such liberalization of specifications, inasmuch as factory space, machines, tools, and workers were available for handling a substantial addition in business and such an increase in business could be expected to assume part of the factory overhead charges and so contribute to an increase in over-all operating profits.

The correspondence between the sales department of the Folsom Pump Company and the Chairman of the Technical Advisory Board of the Department of Agriculture follows:

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C.

OFFICE OF PLANT AND OPERATIONS June 4, 1940

Folsom Pump Co.
362 Vesey Street
Cleveland, Ohio

GENTLEMEN:

The Technical Advisory Board is charged with the task of supplementing existing Federal Specifications by the development of other specifications to be used throughout the Department of Agriculture in the purchase of equipment, materials and supplies which involve the application of engineering principles. To this end the Board has prepared the tentative specification for Air Compressors, Service Station Type.

It is the earnest desire of the Board to prepare specifications which assure the acquisition of equipment adequate for the needs of the Department and at the same time provide for fair competition among manufacturers, as nearly as may be, upon an equal basis and upon a common ground. The attached draft of the tentative specifications [not reproduced here] is presented therefore for your review, criticism and comment. Your cooperation is solicited and you may be assured that your criticisms and comments will be given careful consideration and further that your reply will be held confidential with the Board and will not be construed as any commitment on policy or procedure on your part.

The Board trusts that it may have the benefit of your knowledge and experience in the preparation of specifications.

Very truly yours,
(signed) OTTO ENGELMANN
Chairman, Technical Advisory Board

Enclosure

June 13, 1940

U.S. Department of Agriculture
Washington, D. C.
Attention: Mr. Otto Engelmann, Chairman
Technical Advisory Board

GENTLEMEN:

We thank you for your letter inviting us to review the temporary specifications governing your purchase of air-cooled air compressors.

Our line of single and two-stage compressors compares favorably to the specifications temporarily adopted by your department. We manufacture single stage air-cooled compressors from 1/3 to 1½ H.P. The displacements of these single stage machines vary from 1.5 to 7 cu. ft. per minute. Our line of two-stage units includes compressors from 1 H.P. to 5 H.P. The displacements of these machines vary from 5 to 20 cu. ft. per minute.

We have not adapted any of our compressors to gasoline motor drive, because the demand has not been sufficient to warrant the expense and time involved in making this change. Our records show that approximately 75% of our compressor business consists of two-stage units from 1½ to 3 H.P. with electric motor drive. It is probable that the major portion of your air compressor business will consist of two-stage units of these sizes.

Upon reviewing your general specifications, we wish to congratulate you on the thorough handling of a subject so difficult. However, we have one constructive suggestion to make. Within the past year, our Production Department has adopted a method of testing that absolutely guarantees the volumetric efficiency of each Folsom two-stage machine before it leaves our factory. Each 1½, 2 or 3 H.P. two-stage compressor must pass a low-pressure orifice test with a volumetric efficiency of at least 75% at 175# before it is released. We have pioneered this type of testing and previous to our adaptation of the production testing method, the low-pressure orifice test was considered a laboratory procedure, extremely accurate in results, but entirely too complicated for general production use.

Since we began to use this method of testing, we have discovered that each day several machines of these sizes fail to pass this test, although they would easily pass the conventional stop-watch test formerly employed by Folsom and generally employed by competition. It is necessary to examine these machines, correct the fault and retest them. We have discovered that a particle of dirt or grit in the intake

valve reduces the efficiency as much as 12 to 15% at 175#, and without the low-pressure orifice test, this fault would not have been discovered.

Naturally, any compressor company is willing to submit a certified test showing that one or two of their compressors (possibly picked machines) have passed all necessary efficiency tests made with a low-pressure orifice meter. However, it is extremely important to you that *each* of the two-stage compressors purchased by your department is equally as efficient as those tested by a certified public engineer. We claim that ordinary production stop-watch testing cannot show the extreme loss of efficiency experienced at higher pressures when the slight fault may reduce the efficiency as much as 15%, and eventually cause total failure.

We believe that you would protect yourself more fully and yet not inflict a hardship on any compressor manufacturer if you were to write the following into your specifications:

> Before acceptable under these specifications, each two-stage compressor purchased by this department must be tested by a low-pressure orifice meter and guaranteed to produce at least 75% volumetric efficiency at 175# operating pressure.

We are enclosing bulletins describing our complete line of compressors and we would appreciate your comment on the suggestion given above.

Yours very truly,
FOLSOM PUMP COMPANY
(signed) A. C. Terwiliger
Sales Department

A. C. Terwiliger: CB

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON

OFFICE OF PLANT AND OPERATIONS June 21, 1940

Folsom Pump Company
362 Vesey Street
Cleveland, Ohio Attention: Mr. A. C. Terwiliger

GENTLEMEN:

You may be sure that this office appreciates the suggestions contained in your letter of June 13, 1940 in regard to the proposed specifications for Service Station Type Air Compressors.

The suggestions will be very helpful in aiding the Board in the preparation of a specification for equipment of this type.

Very truly yours,
(signed) W. K. KNAUFF
Acting Chairman, Technical Advisory Board

The assistant sales manager believed that the correspondence reflected on the part of the Department of Agriculture an enlightened policy that must result in clarification of specification statements, improvement in the quality of products purchased, enlargement in competitive bidding, and lowering of bid prices. He regretted the difficulties imposed by the specifications for pumping and compressor equipment that were issued by Army and Navy purchasing boards. It was his opinion that these difficulties could, in many instances, be traced to inexperience and lack of knowledge on the part of the officers detailed to develop specification statements.

Should the Folsom Pump Company have sought further revisions of government specifications on the types of products which it manufactured?

16. GORTON-PEW FISHERIES COMPANY, LTD.

INTRODUCTION OF VITAMIN CANDY

In 1935 the Gorton-Pew Fisheries Company, Ltd., a large producer, manufacturer, and shipper of sea foods and sea products, developed a new type of hard candy, which, because of the inclusion of a special concentrate of fish-liver oil, contained valuable vitamin properties. The officers of the company believed that they had overcome the problems involved in concentrating the fish-liver oil and in manufacturing the candy, and were formulating plans for marketing the product.

After the method of concentrating fish-liver oil had been developed, the company experimented for some time before deciding on the form in which the concentrate should be sold. From past experience in attempts to market cod-liver oil under its own brand name, the company had learned that it was difficult for anyone but a drug manufacturer to market successfully products predominantly medicinal. The decision was made, therefore, to develop a product in which the concentrate of fish-liver oil could be used advantageously and which would have wide appeal to the general public. The item would not be sold primarily as a health product or medicine. The officers of the company decided that

hard candy drops, which might be popularized among young and old because of vitamin properties, filled these requirements most satisfactorily.

In making the vitamin concentrate for the candy, the company decided to use swordfish-liver oil in preference to other better-known types of fish-liver oil. The swordfish-liver oil was considered superior to cod-liver oil because it did not possess a flavor quite so unpleasant as the latter; moreover, the swordfish-liver oil was considered better than either cod-liver oil or halibut-liver oil because a given unit was 300 times as strong in Vitamins A and D (the health-giving vitamins which are present in oil-soluble compounds) as the cod-liver oil and 3 times as strong as the halibut-liver oil. Thus, very little of the concentrate was needed in the candy to give it the desired amount of vitamin strength, one gallon of swordfish-liver oil being sufficient for several tons of candy.

The company flavored its candy with lemon and molded it into pieces of rectangular shape somewhat resembling cough drops. The molds were designed so that the name of the candy could be formed on each piece. Although it was possible to use a number of different flavors, the company expected to use only lemon flavor until the sales possibilities of the candy had been tested. To be sure that the candy was compounded properly and that it was beneficial to human beings, the company had samples tested and approved by an outside laboratory. The officers of the company considered this action necessary, because an overdose of vitamins was known to have harmful effects on the human system.

The company planned to give the candy a name which would suggest its sea origin and which could be remembered easily. Among the possible names which the officers of the company considered and rejected were the following:

Vitavims	Health Savers
Vita Bits	kAnDy
DuoVites	S O S Drops
VitA-Drops	Vitamints
A Bit of Health	DandA Drops
High Seas	Captain Jacks

The decision was made to package the candy in small boxes, similar to those in which cough drops were packed, to be sold at retail for 10 cents a box. The officers of the company realized that the candy would compete for the most part with cough drops,

hard candies, fruit drops, and Life Savers, most of which sold at retail for 5 cents a package; but they decided to charge the higher price since they needed the extra margin to finance the necessary promotion work. In fixing the retail price at 10 cents, they had not decided on retailers' margins or the methods of distribution.

Inasmuch as the candy had been made on only a small scale, the cost of production on a quantity basis was not known. One of the executives of the company stated, however, that the raw materials in the candy were inexpensive. The amount of swordfish-liver oil necessary to make one package of candy cost only 0.15 cent, and the other ingredients were also comparatively cheap. The manufacturing cost was not definitely known because the company planned to have the candy made by an outside firm, in order to avoid, until the company was more certain of the popularity of the product, the purchase of the $20,000 worth of equipment necessary to make candy in its own plant. It was expected, however, that the total manufacturing costs would be only a few cents a package.

Not being familiar with the candy industry, the officers of the Gorton-Pew Fisheries Company, Ltd., desired to act slowly in developing plans for distribution of the new product. They stated that ultimately they hoped to obtain a wide distribution of the candy but that at first they planned to promote it in local areas only, in order to test the sales appeal of the product before spending much money for its promotion. The officers of the company did not expect that their regular sales organization would be able to assist to any great extent in the promotional work on the candy, because the regular salesmen called mainly on independent grocers, wholesale grocers, and chain stores, which were not of prime importance in the distribution o f candy.

At this point, the executives soughtthe assistance of a marketing consultant in formulating plans for putting the new candy on the market.

How should the marketing consultant have proceeded to analyze this problem?

17. INTERNATIONAL PAPER COMPANY

INTRODUCTION OF A NEW PRODUCT

In 1928 the International Paper Company acquired the right to manufacture and sell a patented mulch paper for use in agriculture in the 37 states of the United States east of Colorado. The mulch paper was made from kraft paper; and the company's interest in it arose from the desire to increase sales of kraft paper, since the production capacity of the kraft paper industry was substantially in excess of sales. The mulch paper was to be sold under the trade name Gator Hide, which the company applied to certain of its kraft papers also.

The alleged advantages of mulch paper were that it increased crop yields,[1] caused crops to mature more rapidly, and made cultivating and weeding practically unnecessary. It was first used in growing sugar cane in Hawaii. Later its use was extended with commercial success to the raising of pineapples in Hawaii and British South Africa. In general, Gator Hide Mulch Paper was suitable for all crops except grain crops. It could be used, for instance, for potatoes, cotton, celery, peppers, eggplant, green beans, beets, carrots, cucumbers, corn, squash, cantaloupe, watermelon, sugar cane, small fruits, orchard fruits, flowers, and nursery stocks. On the basis of experiments begun in 1924, the U.S. Department of Agriculture reported that, for a wide variety of crops, the use of mulch paper resulted in an appreciable plant stimulation.[1] Little was known, however, concerning the practical economic value of the paper for use in the United States.

In the manufacture of Gator Hide Mulch Paper, kraft paper was impregnated with high-test asphaltum, thus being made black and also impervious to moisture. In use, the paper was laid over the plant beds or fields in strips, which were anchored along the edges by soil or other means. Planting was done through holes made in the paper or in the space between two strips. The paper was made in two widths, 18 and 36 inches, and in two types, A for annuals, primarily in field culture, and B for perennials in field culture and for garden use.

Prices of Gator Hide Mulch paper to consumers, as suggested by the company, were as follows: $3.50 for a 300-yard 18-inch roll

[1] See Appendices for more detail.

of Type A, or for a 150-yard 18-inch roll of Type B, and $7 for a 300-yard 36-inch roll of Type A, or for a 150-yard 36-inch roll of Type B. At these prices less trade discounts, the company expected to earn a net profit on an annual sales volume of more than 1,000,000 of the 18-inch rolls or their equivalent in 36-inch rolls. On a smaller volume than that, sales would be made at a loss.

At the oustset the International Paper Company decided to undertake to sell mulch paper directly to users. Inasmuch as neither distributors nor potential users were familiar with the product or with the correct methods of using it, the company was unwilling to resort to an indirect method of sale immediately. In order to reach potential users, the company inserted three full-page advertisements in leading farm publications. One insertion appeared in May, one in June, and one in July. The advertisements were spectacular, bearing large headlines which spoke of the "miracle" of the mulch paper. Photographic illustrations of crops raised with, and of others raised without, the use of mulch paper were included. Each advertisement carried a coupon and gave information as to prices and methods of ordering. The company also mailed to a selected list of potential distributors and users a booklet that related the history of the product, the methods of using it, and the benefits to be derived thereby. The magazine advertisements and the booklet resulted in the sale of 5,000 rolls of mulch paper; 25,000 inquiries from various parts of the United States were received.

In the summer of 1928, the company undertook to develop a marketing plan better suited to widespread distribution. Its first step was to decide what type or types of users it should seek to reach.

There were several potentially important types of uses for mulch paper: for annual and seasonal farm crops, for home gardens, for truck gardens, for orchards, for nurseries, and for flowers. The company was convinced that, of the various markets, the home garden market and the truck garden market would be the easiest to develop. Either of these markets could provide a substantial sales volume. The company judged it expedient to direct advertising and selling efforts to the farmers, who, if they became convinced of the merits of the paper, could be expected to buy it in very large quantities.

After considering the matter for some time, the company decided to distribute the mulch paper through selected coarse-paper wholesalers during 1929. In all, the company secured 35 distributors for its mulch paper.

During 1929 the company spent, chiefly in farm papers, between $150,000 and $200,000 for advertising mulch paper; and sales, expressed in terms of the standard 18-inch roll, amounted to 140,000 rolls. The sales in 1929 were the result of the efforts of the company's salesmen to sell carload quantities to paper wholesalers. The latter, however, were unable to sell the mulch paper to ultimate users since their contacts with the market were limited. Thus, in 1930, sales fell to almost nothing, and the company was back where it started. Wholesalers were holding unsalable stocks, and some users were dissatisfied with the product.

In 1931 a new manager was placed in charge of the mulch paper division. He had had long experience with seed wholesalers, was well acquainted with farming conditions and farm products, but knew very little about the paper business. After studying the problem, he reached the following conclusions:

1. The use of paper wholesalers was wrong because they did not reach the potential users of mulch paper.
2. Direct sale to large users was necessary because of the educational job to be done. Farmers, for instance, were skeptical about "papering the ground," and the economic value of mulch paper was not always apparent in one season; mulch paper might not show real savings in seasons of ideal growing weather.
3. The home garden market was a logical one for the company to seek.
4. The price of the product was entirely too high.

The manager believed that mulch paper had real advantages but that the development of the market should be slow and gradual. He realized that a change from paper wholesalers to some other type had to be made tactfully because these firms were very important factors in the distribution of other lines of the International Paper Company.

In view of these conclusions, exclusive sales rights were withdrawn from paper wholesalers in January, 1932. The company previously had established a garden package 18 inches by 45 lineal feet, to sell for $1 at retail, in order to help wholesalers to dispose of unsold stocks. Though this package was promoted by a few advertisements in national magazines, the sales in 1931, while

encouraging, were not sufficient to make appreciable inroads on the stocks of wholesalers. In January, 1932, prices to consumers were lowered. The price of the 18-inch roll, for instance, was reduced from $3.50 to $3, and the garden package from $1 to 65 cents. Wholesalers' inventory losses by reason of the price reduction were met by the International Paper Company.

In 1932 three salesmen were employed to sell direct to farmers in the Atlantic coastal section. When they received an order, they gave it to a wholesaler, if one with a stock was near by; otherwise, the order was filled direct by the company. These three salemen soon were selling more mulch paper than all the 35 wholesalers who carried an inventory of the product; but in the opinion of the new manager this evidence was inconclusive with respect to real demand for mulch paper, because the sales of the salesmen were not large. This direct-selling campaign continued during 1933 with slowly growing but still small total sales. A machine for laying mulch paper, which could be attached to a tractor, was developed by an implement company in 1932.

Believing that one market capable of immediate development was the home garden market, the manager of the mulch paper division took great interest in a device, called the "Come-Pakt Planned Garden," originated by a man not associated with the company. The Come-Pakt Garden consisted of a sheet of mulch paper carrying a design for a garden, and it included seeds and fertilizer. The originator had a patent on the idea and sold the patent rights to the International Paper Company. For the 1934 market the garden was redesigned; Burpee's seeds and Vigoro fertilizer were used in the preparation of these gardens because the products were of good quality and were widely known. The gardens were made in four sizes: a small size for sale in variety chains; three more sizes for other stores, 10 feet by 18 inches, 10 feet by 24 inches, and 10 feet by 36 inches. The suggested retail prices were 20 cents, $1, $1.50, and $2, respectively. The larger sizes were packaged in round containers; the small size was placed in an envelope.

The manager of the mulch paper division decided to sell Come-Pakt Gardens through variety chains, retail grocers, and retail hardware stores. Lacking an advertising appropriation, he concentrated sales efforts on grocery stores because he believed that a display in grocery stores was likely to reach a maximum number of people. According to a field survey conducted by him, 18 people

went into a suburban grocery store for each one going into a drug store, a hardware store, or the hardware department of a department store. The company did not sell direct to retailers but relied on wholesale grocery and wholesale hardware companies to sell to retailers and to see that Come-Pakt Gardens were displayed.

During the 1934 season three salemen working with brokers made contacts with wholesale grocers and wholesale hardware firms. Shipments to wholesalers were begun in January, 1934. At the end of the 1934 season 350,000 units, including the small packages stocked by Woolworth and Kresge stores, had been sold. This number was equivalent to about 8,000 rolls of mulch paper.

Though the sales in 1934 were satisfactory, the manager planned to improve the Come-Pakt Gardens for the 1935 season. He believed that the use of the Come-Pakt Garden eventually would create a demand for mulch paper for other garden uses and for farm cultivation. If this forecast proved to be correct, the company again would have to seek retail distribution channels for the bulk sales of mulch paper. In 1934 the company continued direct sales of mulch paper in bulk to large users; sales increased 14% over 1933. This increase was the result of 1933 users' buying greater quantities in 1934.

How should the management of the International Paper Company have analyzed its experience up to date in the marketing of mulch paper?

Appendix A

Excerpts from U.S. Department of Agriculture Technical Bulletin 75 (May, 1928) on *Crop-Plant Stimulation with Paper Mulch*, by L. H. Flint:[1]

"The experiments as above described [during the years 1924 through 1927] lead to the conviction that many crop plants under the growth conditions of the eastern United States characteristically give a definite and favorable response under impervious-mulch conditions. Twelve crops have been mulched in more than one season, and in each of the 33 trials involving these crops the mulch increased the yield. Fourteen crops have been mulched for one season only, and in 12 of these the mulch increased the yield. In two instances an unfavorable action of the mulch was noted. . . . But there appears to be no

[1] Pages 11, 12, 13, 15.

reason for expecting a uniformly favorable reaction to the mulch, and it is rather to be expected that some crops under some conditions would be adversely influenced by it. It is clear, however, that under the conditions of these experiments the majority of crops were stimulated by the mulch. Moreover, since these tests extended over four years, involving repetitions under different conditions of soil and climate, they seem to offer substantial evidence that a favorable response to the impervious mulch on the part of most crops is to be expected.

"The practical use of such a mulch is clearly associated with the economics of labor, markets, particular crops, and particular climatic conditions. The use of the paper unquestionably hastened the maturity of some crops, and thereby it may be assumed to be of interest to growers anxious for the early markets. In certain sections, moreover, this hastening of maturity might permit two crops to be grown in a season not quite long enough for two crops ordinarily. . . .

. . . .

"The extent to which paper mulch will find a place in gardening and agriculture can be determined only through wide individual experimentations. The directions which these experiments should take, however, could be determined more intelligently if it were known just what changes in the plant's environment follow the use of paper mulch. As previously pointed out, this phase of the investigation has not been completed. . . .

"Yields obtained from paper-mulch trials at Arlington Experiment Farm in 1927:"

Crop	Mulched	Unmulched (control)	Ratio (treated ÷ control)
	Grams	*Grams*	
Green Corn*	59,977	15,100	3.972
Beets*	46,330	20,830	2.224
Okra*	68,084	36,457	1.868
Carrots*	41,447	27,641	1.499
Green Beans:			
First Crop*	28,950	19,868	1.457
Second Crop*	12,043	8,391	1.435
Squashes*	95,850	73,000	1.313
Tomatoes*	84,686	58,995	1.435
Pumpkins*	46,805	26,762	1.749
Peanuts*	2,560	4,783	0.535
Lima Beans*	22,879	20,015	1.143
Spinach (first clippings, Nov. 10)†	1,048	170	6.165
Summer Turnips†	158.7	50.95	3.115
Sweet Potatoes†	1,632.2	804.89	2.028
Celery†	1,443	764.5	1.888
Cabbage†	1,695	963	1.760
Swiss Chard (first clippings)‡	34.7	20.4	1.701
Lettuce‡	33.06	14.17	2.333

* Total weight from equal areas.
† Average weight per plant.
‡ Average weight per stalk.

APPENDIX B

AGRICULTURAL STATISTICS ON FARM VALUE PER ACRE AND YIELDS PER ACRE FOR SELECTED FARM CROPS

Crop	Period	Farm Value			Average Yield per Acre in Any One Year for the U.S. and Yields per Acre for Highest and Lowest States			
		Average Value per Acre	Range of Value					
			Highest Year	Lowest Year	Year	Average	Highest	Lowest
Cantaloupes	1921–1926	$226.02	$279.40 (1922)	$175.00 (1926)	*			
Carrots	1923–1926	180.93	298.80 (1924)	159.80 (1925)	1925	285 bu.	481 bu.	184 bu.
Corn	1921–1927	18.84	22.50 (1924)	12.50 (1921)	1927	28 bu.	41 bu.	13 bu.
Cotton	1919–1927	36.31	61.40 (1919)	23.60 (1921)	1934	169 lb.	548 lb.	57 lb.
Peppers	1921–1926	511.31	766.00 (1921)	326.10 (1926)	1926	255 bu.	400 bu.	85 bu.
Potatoes	1919–1927	126.62	175.50 (1925)	72.90 (1922)	1923	108 bu.	258 bu.	50 bu.

* Production of cantaloupes is divided into early, intermediate, and late classifications. For the year 1926 the highest yield and the lowest yield for each of the three sections of the United States thus divided according to season of production, was as follows:

Classification	Highest	Lowest
Early	132 crates	78 crates (std.)
Intermediate	200 crates	50 crates (std.)
Late	171 crates	65 crates (std.)

Sources: U.S. Department of Agriculture, *Statistical Bulletin* 10 (Washington, Government Printing Office, 1925), pp. 4–5; *Statistical Bulletin* 22 (1928), pp. 16–18, 35; *Statistical Bulletin* 28 (1930), pp. 11–17; U.S. Department of Agriculture, *Yearbook of Agriculture, 1930* (Washington, Government Printing Office, 1930), p. 504; *Yearbook of Agriculture, 1935* (1935), pp. 426–427.

V

CHANNELS OF DISTRIBUTION

A. CONSUMER GOODS

1. CRESTWOOD COMPANY

TIRE CONSERVATION PROGRAM FOR A MILK DISTRIBUTOR

In January, 1942, the management of the Crestwood Company, one of the largest wholesale and retail distributors of milk and allied products in a metropolitan area, was confronted with the urgent need of devising a plan for conserving tires as a result of the tire-rationing regulations issued by the OPM. The outbreak of war in the Far East, which was the source of 98% of the normal supply of crude rubber for the United States, had greatly jeopardized the possibility of further importation from that area. Consequently the OPM had drastically reduced the quantity of rubber allowed for civilian consumption. The portion of the regulations affecting milk distributors stated that tires, casings, and tubes would be allowed for trucks transporting "farm products and foods," but not for trucks "used for the transportation of commodities to the ultimate consumer for personal, family, or household use."

The daily wholesale and retail volume of the Crestwood Company averaged 150,000 quarts of milk. Two-thirds of this volume was sold to retail customers on 300 routes, while the wholesale trade was served by 35 routes. Since the profit per quart on retail business was twice as great as that on wholesale business (see Exhibit 1), the management believed that the maintenance of its retail volume was imperative.

The task of preparing a report on possible plans for conserving tires was assigned to Mr. Griffith, the Crestwood sales manager. When he had learned the number of new tires in the company's possession, the number and condition of the tires then being used on the company's retail trucks, the average life of the tires, and the average mileage per truck per day, Mr. Griffith concluded that

the company had a 10 months' supply of tires on hand. By retreading or recapping all smooth tires then in use, the company might be able to make the supply last 14 months; but the future availability of supplies for this work was highly uncertain.

EXHIBIT 1
CRESTWOOD COMPANY
Operating Statistics for Wholesale and Retail Milk Distribution
(Cents per Quart)

	Wholesale		Retail	
Selling Price		12.500		15.000
Cost of Goods Sold		8.500		8.500
Gross Margin		4.000		6.500
Expenses:				
Plant	1.250		1.250	
Delivery	2.125		4.330	
Other	0.500		0.670	
Total		3.875		6.250
Net Profit		0.125		0.250

After some analysis, Mr. Griffith presented the following preliminary report to the management:

In my opinion there are three possible methods of conserving our retail truck tires: (1) by cutting deliveries to every other day; (2) by eliminating call-backs; and (3) by pooling our delivery equipment with that of other milk distributors.

1. **Every-other-day Deliveries.** One way of carrying out this plan would be to combine two routes and use one truck and two men to serve each route on alternate days. For instance, Routes A and B, which are now covered daily by separate drivers, would be covered on alternate days by the same men on one truck with a double load. The two men would be needed to handle the double load and to make collections, and they would be better able to answer inquiries and complaints of customers, and to help them plan their orders under the new delivery system.

The present arrangement of routes and the loads assigned to each route is such that a change to every-other-day deliveries could be accomplished without greatly upsetting the organization of the company. Approximately 30% of the retail routes could be served by trucks carrying a double load without endangering either the merchandise or the equipment. Another 15% of the routes are so close to the main plant or to a distributing center that the drivers could double their loads by call-backs to the depots without appreciably increasing their mileage. Thus 45% of the retail routes could be

served every other day with no additional investment by the company, and with a tire saving of almost 50%.

The remaining 55% of the routes at present require loads which it would be physically impossible to double up. Moreover, these routes are so far removed from any distributing center that call-backs would greatly increase the mileage covered by each truck. There are, however, three possible solutions to the problem of these routes: (1) to maintain the present routes and use feeder trucks; (2) to increase the number of routes, thus reducing the size of the load per route to a point where double loads would be possible; and (3) to establish additional depots in order that call-backs be made with little added mileage. According to my estimates, the tire-mileage saving would be fairly substantial under any one of these arrangements.

Another plan for every-other-day deliveries would be to divide each route in half and use one truck and a driver to cover each half on alternate days. This system would most nearly preserve present conditions, since the driver would continue to serve his usual route and could maintain close contact with his customers. Under this plan there might be a saving of about 30% in tire wear. For instance, under the present system, the driver on Route A must travel 3 miles to get to the route from the plant, 10 miles to cover the route, and 3 miles to return to the plant. But if he delivered a double load to each half of the route on alternate days, he would travel only 11 miles a day in all.

The third method of delivery on alternate days would be to divide the area of one route among three adjacent routes and deliver to half of each of these three revised routes every other day. Routes C, D, E, and F, for instance, are all located 3 miles from the plant, require 300 quarts each, and cover 12 miles each. Thus the four drivers together travel 72 miles a day. Under the suggested arrangement, Route F would be divided among the other three drivers, and each driver would deliver 400 quarts over half his new route, or 8 miles, each day. Thus the total distance traveled would be 42 miles, resulting in a saving of almost 42% for these routes. The drivers whose routes were absorbed could replace the men who leave to join the armed forces or to take jobs in defense industries.

The successful adoption of any of the foregoing plans would be dependent on the cooperation of the consumers and the competing milk distributors in the area. Undoubtedly the consumers would be inconvenienced by every-other-day deliveries, but once the need for such a step becomes apparent they should be glad to cooperate. The cooperation of competing milk dealers, however, might be more difficult to obtain. Some of the smaller dealers might continue to deliver daily in the hope of securing new customers. Others who have anticipated the rubber shortage may have built up a large reserve and thus might be in a position to refuse to cooperate with their less fortunate competitors. Therefore, the adoption of the every-other-day delivery plan on any large scale probably would require the help of the Milk Control Board for this area.

The practice of dating bottle caps, which is required by the State Board of Health, might also be a stumbling block to every-other-day deliveries. Under present conditions, milk is usually pasteurized and dated on one day and delivered on the next. With the adoption of every-other-day deliveries, the customer would have milk on hand that might be two or three days old, depending on her rate of consumption. The customers with small children in the family would be likely to object on the ground that this milk would be injurious to them. This problem would have to be solved before every-other-day deliveries could receive widespread consumer sanction.

There is also the problem of what should be done with the saving in expense resulting from every-other-day deliveries. How great would be the actual saving in out-of-pocket expense? Should the milk dealers retain it all? Should the consumer receive part of it in the form of lower prices? Should the route drivers be paid higher wages for the heavier loads they will be forced to carry?

There is a possibility, also, that the credit risk would be increased by every-other-day deliveries. Whereas collections are now made on the same day each week, under the new plan the driver might collect only once in two weeks. For most of our customers this extension of credit could be accomplished without any difficulty; in the poorer sections, however, it might cause fairly substantial losses from bad debts. An alternative plan might be to collect each week but on irregular days.

2. **Elimination of Call-backs.** Because of highly competitive conditions in the milk business, we have all had to offer expensive service in the form of special deliveries and call-backs. In the early hours of the morning, when most customers are still sleeping, the route man delivers the milk. After he has completed deliveries, he goes over the route again selling special products and collecting accounts. If we can rearrange route schedules so as to permit the route man to deliver the milk, make the extra sales, and perform his collection functions at one and the same time, we can reduce mileage approximately 30%. This program would mean that the route men would not leave the milk depots until 7 a.m. and would not complete their deliveries until noon or early afternoon. Such a change would no doubt be inconvenient to many customers, and the milk companies would have to undertake an educational program to obtain customer cooperation.

3. **Possible Pooling of Delivery Equipment.** On the surface it might appear that pooling the equipment of all retail milk dealers would be the most logical method of conserving tires. The alleged economic waste in the individual retail delivery of milk is a familiar argument. Theoretically, at least, large savings could be made if, instead of six milk trucks going down a street each morning, all the deliveries on that street could be made by one truck carrying the products of all the companies and distributing to all the customers. Such a program, of course, would necessitate a fairly large increase in the number of routes in order to reduce the load per route.

There are many drawbacks to such a program, however. The various milk distributors have their producing plants scattered all over the area. It would therefore be necessary to build a number of new distributing depots at which the products of the several distributors could be gathered for delivery on the various routes. Hence many trucks would have to be employed on a shuttling service, transporting milk from the producing plants to the distributing depots and returning the empty bottles for sterilization. Furthermore, the various grades of milk and different types of customers of the several companies would make the task of the route man very difficult. If he had to deliver and collect at the same time, it is reasonable to suppose that he would not be able to complete his route before nightfall. For these reasons any general pooling project appears impractical. There is also the question whether the Department of Justice might not have something to say about such concerted operations.[1]

Even though any general pooling of equipment seems inadvisable, we might consider the possibility of pooling our equipment with that

[1] On March 12, 1942, the Office of Defense Transportation and the Department of Justice issued a joint statement, excerpts from which were as follows:

"Advice and assistance will be given to local business enterprises seeking to readjust local delivery services as a means of conserving trucks, tires, and other equipment and materials, the Office of Defense Transportation announced today.

"Effective immediately, proposed plans for pooling deliveries, curtailing services, or other joint action may be submitted to the ODT for consideration and approval. Under an arrangement worked out by the ODT and the Department of Justice, the ODT will submit all such plans to the Department for clearance as to their legality under the antitrust laws.

. . . .

"Any action taken in accordance with a plan approved by the Office of Defense Transportation cannot be prosecuted under the antitrust laws. It is not a conspiracy so long as it follows a plan approved or requested by the appropriate government agency. The emergency requires that the decision of the Office of Defense Transportation that this procedure is in the interest of efficient transportation during the period of national emergency be taken as final.

. . . .

"Even without specific approval, programs established during the emergency for the sole purpose of conserving rubber and other scarce materials used in local delivery services are obviously not violations of the antitrust laws. Such violations would arise only if such programs included unreasonable restraints of trade not logically related to conservation, such as price fixing, elimination of independent businessmen, or perpetuation of inefficient systems of distribution. Certain safeguards which will make it easier to avoid unreasonable restraints of trade are set forth below in statements concerning the two most common methods used to conserve tires.

"(1) *Pooling of delivery service.* This method involves joint use of the same truck to deliver goods sold by competitors each of whom formerly made separate arrangements for delivery. It eliminates duplicate mileage of delivery trucks down the same street in residential areas.

"The mere establishment of a jointly used facility by a group of rival businessmen does not necessarily violate the antitrust laws. Jointly maintained inspection departments, statistical bureaus, and similar agencies have long been operated in many industries; and in some cities large department stores have maintained a joint system of package delivery for many years. The Department of Justice sees no reason to regard joint systems of delivery during the emergency as violations of the

of the Hillsdale Company, our largest competitor. Both companies carry similar lines of merchandise and use containers that are practically the same. Furthermore, we both cover substantially the same territories, and our milk depots are located at convenient places to serve these territories. If a route was typically divided in half and each driver delivered the products of both companies to half the route, the saving of mileage would be roughly 30%. (This is because the mileage to and from the routes would remain the same, and only the actual route mileage would be cut in half.) If, however, it should be possible to cover a whole route for both companies with one truck manned with two men, the saving in mileage would be approximately 50%. These estimates of savings employ substantially the same assumptions as used in connection with the every-other-day delivery plan.

In view of the fact that a general pooling arrangement does not seem to be feasible, and in view also of the fact that pooling our equipment with that of the Hillsdale Company apparently would produce no greater savings than the every-other-day delivery plan, it is my present belief that we should devote our principal attention to working out a program to reduce deliveries to every other day and to eliminate all special deliveries and call-backs.

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antitrust laws if they are established for the sole purpose of conserving rubber and are so organized that they do not in fact accomplish additional purposes of restraining trade; however:

"(*a*) Competitors should not be excluded from the market or handicapped in their access to it by discrimination in the use of joint systems of delivery. Under ordinary circumstances, any competitor is free to set up his own delivery system or to hire the service of a commercial trucking company. The present emergency has destroyed or severely limited these alternatives. Therefore, in any situation in which the market is so small or the competitors so few that the maintenance of two or more joint delivery systems is not practicable, exclusion of any competitor from the right to use a joint system probably would amount to his exclusion from the market, and discrimination against him in service rendered or charge imposed probably would amount to joint activity to handicap him in the market. Such exclusions or handicaps probably would be in violation of the antitrust laws.

"(*b*) Joint delivery should not be made the excuse for joint selling activities. The merger of delivery service does not require the merger of the facilities which produce or sell the goods, the setting up of joint sales agents, nor the adoption of a single brand name to replace the separate brands formerly sold by business rivals. To extend a program of joint action in these directions is to raise issues under the antitrust laws which are irrelevant to the central need to conserve rubber. Trades which have been accustomed to use the deliveryman as salesman and collection agent may be under especial temptation to delegate to the drivers of jointly operated trucks the functions of jointly representing concerns in selling as well as delivery. However, other arrangements for sales promotion can be worked out which involve less risk of conspiracy to raise prices; and if such joint selling schemes are adopted and unreasonable restraints upon commerce ensue, the restraints cannot be regarded as a reasonable result of the rubber shortage.

"(2) *Diminishing the frequency of delivery service.* Such a program is often practicable only when jointly undertaken, because any competitor who made deliveries more frequently than his competitors would enjoy a substantial advantage which would enable him to divert trade to himself. Where such a restriction of delivery service contains no other feature than a plan to conserve rubber during the emergency by reducing tire mileage, the Department of Justice does not regard it as an

There were some other possibilities for effecting savings in tire mileage to which the Crestwood Company did not at the time give serious consideration. One of these was the suggestion that the retail milk marketing area be divided into zones, each of which would be served by only one company. There were obvious difficulties in the way of any such program. Since there were 400 milk dealers in the area, it would be necessary to divide the market into 400 zones. Such a division presumably would have to be effected by government authority. Even if an equitable division could be made, there probably would be widespread consumer dissatisfaction, inasmuch as violence would be done to consumer preferences for the milk handled by particular companies. To allay such consumer dissatisfaction would presumably require standardization by government authority of grades of products and methods of handling. Naturally, large private concerns that had spent time and money building up customer goodwill would be bitterly opposed to such a program of standardization. In other words, any project for zoning the retail milk market would inevitably lead to the conversion of the milk business to a public utility.

Quite a different line of thought pointed in the direction of substantial reduction, or possibly complete elimination, of the house-to-house delivery of milk. The social desirability of such a

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unreasonable restraint of trade within the meaning of the antitrust laws. Care should be taken, however, to avoid making this program a basis for the accomplishment of restraints not logically involved in it."

On May 5, 1942, *Victory* carried the following report of a general order by the Director of Defense Transportation:

"Joseph B. Eastman, Director of Defense Transportation, April 23 issued a general order curtailing local delivery services as a means of conserving transportation facilities and equipment.

"The order (General Order ODT No. 6) prohibits most special deliveries and 'call-backs,' and limits the number of deliveries and the mileage of local delivery carriers.

"Effective May 15, local carriers are forbidden to make any special deliveries except to hospitals and the armed forces of the United States, and except emergency deliveries of supplies necessary to protect the public health, life and safety.

"As of the same date, the order prohibits call-backs made in a second attempt to deliver shipments on the same day or to make collections, and forbids carriers to make more than one delivery to any one person in a single day. However, if deliveries to one person are so large as to require more than one vehicle, they may be considered as a single delivery.

"After June 1, local carriers using rubber tires are required to reduce their total mileage by at least 25 percent each month as compared with the corresponding month in 1941. In computing the mileage reduction, mileage saved by cutting down on deliveries and by eliminating special deliveries and call-backs may not be included."

development was urged in an article appearing early in 1942, from which the following excerpts are reproduced:[1]

In the days when the fluid milk business started in a big way home refrigerators were relatively scarce compared to the people who wanted to buy milk and as the big milk dealers possessed efficient refrigerator units, competition soon established the sales value of daily doorstep delivery of milk for retail customers. The plant processing and chilling would preserve the quality until consumed and replaced. I will not go into the details of how the changes in general demand forced the big dairy companies to rely on the grocer for the distribution of most of the farmers' surplus milk which was processed into other forms—largely butter and cheese. This fact makes the milk business unique among American industries, for in the dairy industry the by-products exceed the original base product as the making of both butter and cheese had been gradually passing from the farm to the factory set-up. Thus dealer control was an easy transition and I feel a permanent set-up so far as dairy product distribution is concerned.

The purpose of all this story is to create a background for stating my belief that the day when most of our fluid milk will be sold on a doorstep delivery basis has gone by and this declining percentage of home delivery will not again turn upwards. The recent tire rationing order is not the cause any more than that one last day at the office is the cause of a nervous breakdown. The cards have been set against home-delivered milk for a long while and tire rationing merely caused the jolt that brought the real causes out in the open and made milk dealers check up on the trends in their own business. In this trend I feel there is one of the greatest opportunities the independent grocers have had for a long while.

At the Sales Executives Conference held at the Statler a few weeks ago, I had occasion to comment on this trend in the milk business. I ventured my prediction of less home deliveries on the argument that there was less need for home delivery now than when the fluid milk business was started. I tried to point out that the increased use of the automobile which allowed the woman shopper to bring home 25 pounds of groceries instead of only 5 or 10 had already led to an increase in the retail grocery over-the-counter milk deliveries and these had reached such volume that the amount of the differential between cash and carry and delivered milk had become virtually a national problem that continuously plagued the grocers, the dealers, and the milk boards alike. Thus the auto is one cause of the change.

A second cause lies in the great educational campaigns that have put one or more refrigerators into almost every home. This means that cash and carry milk and even grocery store delivery of chilled

[1] Leavitt Parsons, "The Grocer's Opportunity," *The Yankee Food Merchant*, January, 1942, pp. 12 and 13. See also A. M. Freiberg, "Milk Delivery: Necessity or Luxury," *Harvard Business Review*, Vol. XX, No. 1, Autumn, 1941.

milk is no longer a general health menace. It can be kept for days without spoilage. This means that the big argument of spoilage which put the milk dealers into doorstep delivery business isn't as powerful as it used to be and the dealers I have checked with in different localities find that more and more of their customers are drifting to over-the-counter milk sales with the result that their store wholesale business is showing a constantly larger proportion of their total sales.

. . . .

In this connection it is interesting to note that in some sections dealers have already adapted their marketing plans to this new trend. I have just read a report on the operations of the Rockford dairies, a subsidiary of the Dean Milk Co. of Chicago, that has been the biggest milk distributor in Rockford, Illinois—the state's third largest city. Twelve years ago it had 72 retail routes. The depression brought about the first trimming and these were reduced by December 1st, 1941, to 30 retail routes and 4 wholesale routes. Then, as suddenly as the Pearl Harbor surprise, the company quit all its home delivery service and changed to store deliveries only. We won't discuss the details of the price wars and the drop in price to 10¢ paper bottled milk in the grocery stores. That's a whole new problem. However, the feature that interests me is the fact that although the company gave up all its home delivery routes, in fact even turned some of them over to competitors who promised to employ the same help, they actually got such cooperation from their wholesale customers among the retail grocers that their total volume of milk sales jumped. For instance, the whole 34 routes averaged a total of 6,900 quarts a day while on the first day after they went "all out for wholesale" the 8 new routes with their cooperating grocery stores took 7,700 quarts—six days later this jumped to 9,000 quarts and both the Rockford dairies and the local grocery trade are happy about it.

This is the kind of situation that I feel might also be promoted in New England with great profit to the grocer with a saving to consumers and with a total increase in the consumption of milk which would be pleasing and profitable both to the farmers and the wholesale dealers.

Under public regulation in the state in which the Crestwood Company operated, retail stores were not permitted to sell bottled milk at a differential of more than 1 cent under the delivered price charged by the house-to-house distributors. Some retailers stated that their sales of fluid milk had declined sharply after the enactment of this regulation.[1]

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[1] See the case on "New England Milk Prices" in Malcolm P. McNair and Richard S. Meriam, *Problems in Business Economics* (New York, McGraw-Hill, 1941), p. 564.

Since the Crestwood Company regarded itself as primarily a retail milk distributor, it did not seriously consider the idea of transforming itself into primarily a wholesale business. Furthermore, the management was convinced that apart from the privations and vicissitudes inevitable under a war economy, the demand of consumers for daily house-to-house delivery of milk was in no sense abating but, on the contrary, promised to persist indefinitely.

What action should the management of the Crestwood Company have taken?

2. GOOD HUMOR CORPORATION

HOUSE-TO-HOUSE DISTRIBUTION OF FROZEN FOODS

During the first week in April, 1940, the chairman of the board of the Good Humor Corporation received a request from salesmen that their commission on frozen foods be made equal to that regularly paid on sales of the company's ice cream products. For three months, executives had been conducting an experiment in house-to-house selling of frozen foods in an attempt to find a means of utilizing the company's distribution facilities during the off season for ice cream. The salesmen wanted a decision before they started their regular ice cream routes on April 17. The chairman proposed to the other officers not only that the commission matter should be settled at once but that the whole question of the sale of frozen foods should be reexamined in the light of the company's experience in order that the organization might enter the ice cream selling season with its objectives clearly defined.

The Good Humor Corporation manufactured and distributed a line of ice cream products, which, in 1940, included 5-cent ice cream cups, 10-cent ice cream cups, 10-cent sundaes, and 10-cent chocolate-covered bars called "Good Humors," as well as pint packages for home use. With the exception of a very few stationary stands at public beaches, the products were distributed from trucks, trailers, tricycles, and pushcarts, which moved from place to place over a definite route on a fixed schedule. Although the sales were largely confined to eastern cities, the products were also sold in Chicago and Detroit. The distribution of sales by sections and types of equipment was as shown in Exhibit 1.

EXHIBIT I
GOOD HUMOR CORPORATION
Total Sales by Districts, 1939

District	Type of Equipment	Sales	
Brooklyn and Queens:			
Flatland Queens	Cars	$ 83,891	
North Queens	Cars	98,056	
West Brooklyn	Cars	94,256	
Williamsburg	Tricycles	56,467	
Bensonhurst	Tricycles	58,558	
Long Island City	Tricycles	70,094	
Rockaway Avenue	Tricycles	52,471	$ 513,793
Oceanside:			
Nassau	Cars	$ 99,722	
Suffolk	Cars	97,417	
Long Beach	Tricycles	42,646	239,785
Mount Vernon:			
Bronx	Cars	$120,734	
Hudson River	Cars	101,686	
East Westchester	Cars	99,156	
Bronx	Tricycles	80,429	402,005
Connecticut:			
New Haven	Cars	$106,021	
Hartford	Cars	105,885	211,906
New Jersey:			
Southern	Cars	$117,585	
Northern	Cars	138,090	
Central	Cars	123,914	
Newark	Tricycles	58,566	438,155
Boston:			
North	Cars	$ 62,687	
South	Cars	63,619	126,306
Total Eastern Divisions	....	....	$1,931,950
Chicago:			
North	Cars	$100,599	
South	Cars	86,019	
West	Cars	79,180	
North	Tricycles	59,751	
South	Tricycles	82,343	
East	Tricycles	38,418	
West	Tricycles	55,206	501,516
Detroit:			
Western	Cars	$ 87,156	
Eastern	Cars	72,401	
Store	....	1,361	160,918
Grand Total	....	....	$2,594,384

NOTE: Trailers and pushcarts were classified as auxiliary units with cars and tricycles.

It was the aim of the company to develop as nearly a uniform method of sale as possible. Therefore, each group of approximately 20 car salesmen was supervised by a manager, who, in turn, was responsible to a district manager and the general sales manager. The salesmen were checked out by the managers each morning at 11 o'clock and were expected to stop work at 11 in the evening. In many cases, however, they continued to work until a much later hour since they were paid on a commission basis. The salesmen received an average commission of 22% and a gasoline allowance for driving to and from their territories, but they paid for all gasoline used within their territories. Their earnings varied widely; although the average was about $35 a week for the men selling from trucks, several of the better salesmen earned over $100 a week during the summer. In terms of total sales the company had been very successful, but its net profits had been decreasing since 1936 (see Exhibit 2). In 1939 the company showed a smaller net profit than it had in 1930, despite the fact that sales were 2½ times larger. This decrease in profits was entirely the result of a higher cost of distribution, since the gross margin on sales had risen over 5% during the period. Sales for selected years during the period 1930–1939 had been as follows:

1930	$1,002,093
1932	1,441,489
1934	1,483,108
1936	2,701,428
1938	2,614,704
1939	2,594,384

Executives realized that part of the increased cost—for instance, the increase in salesmen's compensation in line with generally higher wages for similar work throughout the country—could not be avoided. An examination of operating cost figures, however, pointed to one outstanding weakness: The company could operate for only 5½ months during the year, from April 15 to September 30 (see Exhibit 3). This fact not only meant that the company's manufacturing plant and 450 trucks (see Exhibit 4) stood idle half the year; it also raised a major personnel problem, which could be met only at a high cost. If the company's supervisory staff were not kept together from year to year, a new organization would have to be built each season. Approximately 100 people, therefore, including managers, supervisors, the factory superintendent,

stenographers, and the officers, were kept on the pay roll during the winter in spite of the fact that the only work to be done was putting the trucks in condition and developing plans for the following season. The route salesmen, however, were all released each fall and hired again in the spring. It was estimated that each year only 50% of the truck salesmen and a much smaller number of

EXHIBIT 2
GOOD HUMOR CORPORATION
Comparative Consolidated Profit and Loss Statement for Selected Years, 1930–1939

	1930	1932	1934	1936	1938	1939
Net Sales	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %
Manufacturing Cost of Sales:						
Raw Materials	15.41 %	14.14 %	16.16 %	16.31 %	14.27 %	12.98 %
Supplies	5.92	3.22	4.79	4.56	5.10	5.24
Plant Labor	4.86	3.46	4.52	3.03	3.45	3.22
Plant Overhead	4.77	4.37	5.04	3.63	3.57	3.65
Plant Depreciation	1.04	2.29	2.67	1.32	1.96	1.66
Total	32.00 %	27.48 %	33.18 %	28.85 %	28.35 %	26.75 %
Less: Cost of Merchandise Used in Advertising	....	....	1.19	1.10		
Cost of Sales	32.00 %	27.48 %	31.99 %	27.75 %	28.35 %	26.75 %
Gross Margin on Sales	68.00	72.52	68.01	72.25	71.65	73.25
Operating Expenses:						
Storeroom Expense	....	3.97 %	2.27 %	2.98 %	3.76 %	3.79 %
Car Expense	7.03 %	12.65	11.89	11.48	14.00	14.17
Depreciation on Cars, etc.	4.15	7.77	6.42	1.57	2.81	3.93
Salesmen's Compensation	15.24	18.86	22.36	22.39	21.14	22.92
Other Selling Expense	5.24	13.27	14.76	13.12	14.70	15.29
Administrative Expense	9.50	8.58	7.55	7.30	7.54	8.31
Total	41.16 %	65.10 %	65.25 %	58.84 %	63.95 %	68.41 %
Operating Profit	26.84	7.42	2.76	13.41	7.70	4.84
Sundry Income	1.39	3.06	0.82	0.26	0.31	0.34
Net Operating Profit before Reserves	28.23 %	10.48 %	3.58 %	13.67 %	8.01 %	5.18 %
Reserve for Federal Income Tax	3.45	1.04	0.69	2.28	1.83	1.01
Net Profit from Good Humor Operations	24.78 %	9.44 %	2.89 %	11.39 %	6.18 %	4.17 %

EXHIBIT 3
GOOD HUMOR CORPORATION
Sales by Months, 1939

Month	Eastern Division	Western Division	Total
April	6.69%	8.44%	7.13%
May	20.20	22.55	20.77
June	20.07	22.75	20.73
July	23.00	23.01	22.97
August	21.62	16.47	20.28
September	8.42	6.78	8.12
Total	100.00%	100.00%	100.00%

other types of salesmen returned to work for the company. Therefore, the company was faced with the expense of training new men every spring.

EXHIBIT 4
GOOD HUMOR CORPORATION
Consolidated Balance Sheet, December 31, 1939

ASSETS

	Cost	Depreciation	Net Value	
Current Assets:				
Cash at Banks and on Hand				$ 205,003
Accounts Receivable				52,567
Inventories				66,071
Total				$ 323,641
Lease and Power Deposits				8,625
Plant Assets:				
Land	$ 9,494	—	$ 9,494	
Buildings	35,032	$ 7,800	27,232	
Plant Machinery	336,259	212,931	123,328	
Sales Cars	319,173	138,066	181,107	
Trailers	18,488	7,395	11,093	
Sales Management Cars	26,514	4,694	21,820	
Delivery Trucks	52,043	43,781	8,262	
Furniture and Fixtures	33,709	18,825	14,884	
Total	$830,712	$433,492		397,220
Deferred Expense:				
Plant Alterations and Improvements			$ 52,152	
Prepaid Insurance and Expense			28,947	81,099
Patent Rights, Licenses and Franchises			$694,681	
Less: Amortization to Date			145,820	548,861
Total Assets				$1,359,446

LIABILITIES AND CAPITAL

Current Liabilities:		
Accounts Payable and Accrued Liabilities		$ 27,289
Federal and State Income Tax Reserve		53,193
Unclaimed Dividends		359
Total		$ 80,841
Capital Stock—350,000 Shares of $1.00 Par Value		350,000
Capital Surplus		600,000
Earned Surplus:		
Surplus on January 1, 1939	$299,886	
Add: Net Profit for Year 1939	203,719	
	$503,605	
Less: Dividend Paid October 30, 1939	175,000	328,605
Total Liabilities and Capital		$1,359,446

In 1939, a vice president of the company had suggested that the personnel and equipment might be used during the winter in selling quick-frozen foods from door to door along the same routes on which ice cream was sold in the summer. He pointed out that in most cases the salesmen were known to the housewives and that,

if the Good Humor name was used, much of the company's goodwill would be carried over to the food products. Furthermore, he declared, a preliminary investigation had revealed that the bulk of quick-frozen food sales came in the winter with a decline of as much as two-thirds in the summer months, a fact which fitted the products very well to the company's needs.

The officers of the company agreed that the plan was worth trying. After investigating several brands of quick-frozen foods, they decided on the product of the Birds Eye division of General Foods. The main reason for this decision was the close control over quality which Birds Eye maintained. The Birds Eye representatives agreed to select a group of products which would be most salable and to set prices to be followed by the Good Humor Corporation. The prices were to be the same as those suggested to the retail stores; but since the Birds Eye division did not enforce resale price maintenance, there was no assurance that the prices would not be higher than those in certain stores. The Good Humor Corporation placed an order for $7,500 worth of products to be packaged under the brand name "Good Humor" and delivered as the company required them.

EXHIBIT 5

FREQUENCY OF PURCHASE OF QUICK-FROZEN FOODS, BY INCOME GROUPS

	Income Groups				
	Under $1,000	$1,000–$1,999	$2,000–$2,999	$3,000–$4,999	$5,000 and Over
Number of Replies	42	194	209	158	96
Frequency of Purchase:					
Frequently	33%	25%	31%	39%	51%
Frequently in Winter, Seldom in Summer	....	2	3	6	2
Seldom	67	73	66	55	47

Source: "Life with a Refrigerator," *Woman's Home Companion*, Reader-Editor Report 28 (New York, Crowell-Collier, 1939).

A section of northern New Jersey with a large proportion of upper middle-class families was selected for the test, because a recent survey had indicated that frozen foods were still purchased most frequently by the higher income groups (see Exhibit 5).

Furthermore, the district had been well developed with regard to ice cream sales. The 12 men who regularly covered this section with the ice cream trucks were asked to undertake the selling of frozen foods. The executives offered to pay the men a commission of 10% with a guaranteed minimum of $18 a week and to meet all the gasoline expense of the trucks. These salesmen were considered exceptionally good, some of them having earned over $100 a week during the summer. They all belonged to a local of the Teamsters, Chauffeurs, Stablemen, and Helpers of America Union, as did the drivers in several other territories. The executives therefore discussed the plan with a union representative, explaining that the program was an experiment but that in time it might serve as a means of employing the men the year round.

Before the men began their selling activities, a Birds Eye representative talked to them and explained the merits of the products. A folder was printed to be given to housewives as an introduction to the service. It explained that quick freezing kept the products "fresher than fresh," and on the back listed the items sold and their prices (see Exhibit 6). The procedure established was for the men to spend 4 hours, from 9 a.m. to 1 p.m., covering a regular route every two days. Each man kept a route book, in which he wrote down information about every customer, including which door of the house to enter, the amount of each sale, and incidental remarks, such as whether there was a baby in the house. The afternoons, from 2 to 5:30, were devoted to calling at houses missed during the morning and to canvassing for new business.

It was soon learned that the most suitable time for food sales was in the morning. The men reported that they had no difficulty in getting into a house to present their story, because most people recognized the company truck. The regular procedure was for a salesman to introduce himself and give the housewife a pamphlet describing the product. Occasionally, sample boxes of frozen strawberries were offered to prospective customers as a means of inducing them to try the quick-frozen foods. In his conversation with the housewife, the salesman always stressed the point that the Good Humor Corporation stood behind the product with a money-back guarantee. By the first of April about 2,500 customers were purchasing frozen foods with some degree of regularity.

Among the temporary difficulties which were encountered in the distribution of the quick-frozen foods were inability to get

licenses in two communities, because of old local ordinances which forbade the peddling of meat or fish within the city limits, and price cutting, which certain local stores inaugurated during the first two weeks in which the Good Humor products were sold. Another difficulty was the refusal of many maids to have anything to do

EXHIBIT 6
GOOD HUMOR CORPORATION
Price List Distributed to Housewives

Product	Amount of Contents	Equivalent in Ordinary Foods	Price (cents)
Vegetables:			
Asparagus Cuts	12 oz.	26 oz.	27¢
Asparagus Tips	12 oz.	26 oz.	35
Green Beans, 1-in. Cut	10 oz.	14 oz.	19
Green Beans, Fr. Style	10 oz.	14 oz.	21
Lima Beans	12 oz.	32 oz.	25
Broccoli	13 oz.	23 oz.	25
Brussels Sprouts	13 oz.	1 qt.	25
Corn on Cob	2 ears	2 ears	16
Cut Corn	13 oz.	6 ears	23
Peas	12 oz.	32 oz.	25
Spinach	14 oz.	½ peck	23
Squash	16 oz.	22 oz.	19
Fruits:			
Blueberries	11 oz.	In ordinary fruit much must be thrown away	23
Peaches	16 oz.		25
Raspberries	10 oz.		23
Strawberries	16 oz.		25
Fish:			
Haddock Fillets	16 oz.	48 oz.	25
Sole Fillets (flounders)	16 oz.	64 oz.	35
Shell Fish:			
Oysters	12 oz.	....	35
Scallops	12 oz.	....	35
Meat:			
Chopped Steak	8 oz.	....	18

Prices subject to change

with the frozen food products because they were afraid they might lose their jobs if cooking became too easy. A more important factor was the competition of chain stores, which were undertaking the promotion of frozen foods during the same period. They offered a full line and featured specials from day to day, which attracted the customers' attention. Another problem was the educational work required to instruct the housewife in the proper methods of preparing the frozen foods. The uncertainty of weather

was a continuing obstacle. On rainy or snowy days the housewife was eager to buy in her home; but at the same time it was difficult for the salesman to make his rounds on schedule. Moreover, many of the housewives wished to run charge accounts and pay by check at the end of a week or a month. The company, however, established a definite cash policy, although the salesmen did occasionally extend credit on their own responsibility in particular circumstances.

During the first 2½ months, sales of quick-frozen foods continued to grow. By the time the request for an increase in commission was received, however, the total sales for the entire period of operation had amounted to less than $10,000, and the experiment showed a substantial deficit (see Exhibit 7). Although a considerable part of the expense for the period was nonrecurring, the manager of the New Jersey division stated that in his opinion the experiment would continue to be unprofitable. He estimated that, in order to break even, sales of $38 a day per man were required; the average sales to date had been far below this figure. He believed that the average of 125 calls a day by the salesmen was fully as high as could be expected and that the record of sales to about 80 of these customers each day during the last two weeks of March was satisfactory. The average sale of only 29 cents per customer, however, was not satisfactory; and the manager was convinced that, if a point of profitable operation was to be reached, the average sale would have to be raised. The only way in which this could be done, he believed, was to fill out the line with higher-price products, particularly meat products, in order that the housewife might buy her whole meal rather than only a few items. As an experiment, one or two combinations of fish, vegetable, and dessert had been offered as a unit at a slightly lower price than the total of the separate items; and the customers had responded fairly well. This scheme, however, had the disadvantage of requiring careful inventory control to prevent the possibility of the discount being retained by the salesman instead of passed on to the consumer.

With the approach of the ice cream selling season, the officers had made plans to continue the experiment with frozen foods in the territory where it was already working. The men were to report at 9 a.m. and work until noon on frozen foods. They would then cover their regular ice cream routes during the afternoon and evening until 9 o'clock. The same rates of commission would

obtain, but there would be no guaranteed minimum. When the plan was explained to the men, they objected that they would lose sales in the evening if they stopped at 9 instead of 11, which was the scheduled time for the men not selling frozen foods. They agreed that they were building up a year-round business and that it was necessary to keep up the contacts during the summer even though the volume of sales was low, but they considered that they should be given a commission on the frozen foods at least as large as that paid on the ice cream. They pointed out that, at the lower commission on frozen foods, they would be tempted to try to sell ice cream instead. The chairman did not worry much about this statement, because he believed that a schedule could be enforced on the morning round just as it was for the ice cream business.

EXHIBIT 7
GOOD HUMOR CORPORATION
Operating Statement for Quick-frozen Foods for Three Months to April 13, 1940

Sales		$9,813
Cost of Sales		7,129
Gross Margin		$2,684*
Expenses:		
Salaries	$3,076	
Dry Ice	636	
Truck Alterations	626	
Gasoline	449	
Carrying Boxes	90	
Social Security Tax	114	
Peddling Licenses	100	
Advertising	391	
Uniforms	739	
Stationery	88	
Sundry Expense	223	6,532
Excess of Expense over Income		$3,848

* The available markup was 40 % of the retail list price. Costs of repacking frozen foods into Good Humor cartons were, however, included in cost of sales; and the same was true of various other charges covering art work, composition, dies, and electros for the printing of cartons. Many of these costs were expected to be nonrecurring.

The chairman told the salesmen that, in view of the gross margin available to the company on food products, a 22% commission to salesmen was out of the question. He pointed out that, because the unit sale was certain to be higher than in the case of ice cream, the dollar profit per food transaction might well be larger than the profit per ice cream transaction. He stated that in the managers' opinion sales after 9 p.m. were usually not very large and that the executives would have no objection if the men wanted to stay overtime on certain nights.

Aside from the possibilities of year-round employment for the men and reduction of overhead costs for the company, the chairman believed that the plan had certain other advantages: (1) It gave more people a chance to become acquainted with the company because the salesmen were able to make contacts with housewives who ordinarily paid no attention to the ice cream car in the street; (2) it added new customers because of the tie-up of the two types of products—for example, ice cream and frozen strawberries; (3) there was the possibility at a later date of adding other lines, such as butter and eggs. In spite of these advantages, however, the chairman did not wish to create any disturbance which might upset the company's main business of selling ice cream; in fact, he indicated his willingness to drop the whole project if the demands of the men were not modified.

Should the Good Humor Corporation have continued the experiment of selling quick-frozen foods in conjunction with its ice cream business?

3. STANDARD BRANDS, INC.

DISTRIBUTION OF CAMERA FILM THROUGH GROCERY STORES

Standard Brands, Inc., manufactured several nationally advertised food products, including Fleischmann's Yeast and Chase & Sanborn Dated Coffee, which were distributed by the company's trucks to both chain and independent retail grocery stores throughout the United States. In 1939 the company had devised a plan for the distribution of camera film through its regular retail outlets. In connection with this plan, the executives proposed to offer a developing and printing service. In January, 1940, the New England division was asked to place the service in 60 stores as an experiment. On March 1, the manager of this division learned that the executives were considering the advisability of increasing the number of stores offering the service from 60 to 4,000.

When the film service had first been considered for New England, the division manager was told that one of the large grocery chains in the Middle West had been selling the developing and printing service for more than a year. A Standard Brands executive had

watched the progress of sales in the chain and was convinced that there was an opportunity for profit for his company in a similar venture. At about this time, an inventor approached one of the company officials in an attempt to interest him in a new method of developing and printing film on a mass production basis. Films were fastened together and run through the developing fluid in a continuous strip. The developed negative was then passed before the projector of the inventor's patented machine, and the picture was printed on a roll of sensitive paper on which a beam of light from the projector was directed. The resulting prints were therefore enlargements of the negatives and not "contact prints," that is, prints made by placing the negative directly on the sensitive paper. This new process was not patented, but the details were a secret with the inventor.

The officials decided that the proposal should at least be given a trial. Therefore temporary developing and printing facilities were provided in one of the company buildings in New York, and films were purchased from the Eastman Kodak Company to be sold to a limited number of grocers on six of the company's truck routes out of a small New York city. Within two weeks the service had been sold to 155 grocers; sales for a four-week period during July and August were as shown in Exhibit 1.

EXHIBIT 1
STANDARD BRANDS, INC.
Sales of Film to 155 Stores on Six Routes, Four-Week Period during July and August, 1939

Product	Percentage of Total Sales
Dated Coffee	34.0%
Film (initial sales)	22.6
Tea	20.8*
Film (repeat sales)	8.6
Yeast	5.5
Dessert	4.6
Packaged Coffee	3.9
Total	100.0%

* Sales of tea were high because of a special promotion. This figure was normally between 5 % and 8 %.

At the end of seven weeks it was estimated that the 155 stores had purchased 8,171 films at a price which yielded the company a gross margin of 25.48%. This gross margin amounted to 45 cents a week per store, of which 17 cents was from repeat business. The company salesmen reported that the business was still growing

and that only five stores had discontinued the service for any reason. Figures obtained from the midwestern grocery chain which had been selling the service for more than a year indicated that in 1939 the chain would sell 4,800,000 rolls of film in 3,900 stores, or 1,230 rolls per store. These figures were not surprising, since there were an estimated 18,000,000 amateur photographers in the United States using an average of 10 films apiece annually.

The amount of profit from the developing and printing end of the business was more difficult to determine at the time of the test because of the temporary nature of the equipment which Standard Brands was using; but the executives estimated that with a reasonable volume the net profit per roll should amount to at least 10 cents after deduction of all costs, including a charge for space in a company building. The investment necessary to establish large-scale developing and printing facilities was estimated to be at least $50,000; the only skilled personnel required was the inventor of the machine, who was to be paid on a salary basis.

Although the test indicated that there was an opportunity for profit both in the sale and in the developing of films, the Standard Brands executives were not convinced that the product fitted into the company's scheme of distribution; therefore they postponed further extension of the program until the merits of the service could be carefully studied. The chief advantage of the plan was that it provided extra volume at very little additional cost. Since the films were not bulky and were of relatively high unit value, they could be easily distributed by truck. The executives did not anticipate that much expense would be involved in inaugurating the system, since company salesmen who were calling on the grocers once a week with the regular products would do most of the introductory work. If necessary, specialty men might be employed to sell the initial stock of film; but from then on the salesmen could keep the stores stocked at almost no additional expense to the company. Most salesmen were paid on a straight salary basis. The preliminary estimate indicated that, even after a proportionate share of salesmen's expenses was deducted from film sales, the company could expect to receive a net profit of 10% of sales out of the gross margin of 25% of sales.

A further advantage which the company hoped to realize from the sale of films derived from the seasonal nature of the service. The executives estimated that 70% of the sales of films occurred

in the summer months; sales of coffee and other company products were low during these months.

Company officials believed that grocers would be in favor of the film service because it would provide extra volume at a higher-than-average margin. Probably little personal selling would be necessary, since customers were expected to pick up the films when they saw the display or to ask for them when they needed them.

It was recognized, however, that there were certain disadvantages to the proposal. In the first place, there was nothing to keep competitors from entering the field. Another disadvantage which the company expected to face arose from the growing controversy between druggists and grocers over the increasing activity of the latter in merchandising and selling traditional drug store items. The Standard Brands executives were aware that druggists had been much incensed by the widening sale of razor blades, toothbrushes, vitamins, and proprietary medicines in grocery stores; and although the company sold nothing to the drug trade, the druggists as consumers of the company's products could exert much pressure and perhaps seriously affect the company's sales. Similarly, the photo-finishers were not expected to stand by and lose business without an effort to retaliate.

At the time when the company began to expand its test into 60 stores in the New England area and a similar number of stores in another area, the officials of the Eastman Kodak Company, on reconsidering their relationship with the druggists, were becoming uneasy about selling film to Standard Brands. For this reason, the Standard Brands executives arranged to procure from a Belgian company the Gevaert film, a brand little known to American consumers. In the New England area, this film was substituted for Eastman film in order to study consumer response. The company, however, continued to purchase Eastman film through jobbers for the other division which offered the service. Despite the fact that the Gevaert film was comparatively unknown in the United States, Standard Brands was able partially to offset this disadvantage by offering a higher margin to grocers than was possible on the Eastman film. The grocers would receive 27% of the minimum resale price for Gevaert film and would be protected against price-cutting competitors under the fair trade laws.[1]

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[1] See "Some Notes on Fair Trade Legislation," pp. 531–532, below.

After some delay in acquiring the Gevaert film, the plan was introduced into 60 stores in the New England territory in February, 1940. Films were distributed to retail grocers by several of the company's 120 trucks which delivered perishable products each week to 25,000 stores in the area. The five sizes of films were sold by the grocers at the resale prices established by the producers of all the major brands of film under the fair trade laws (see Exhibit 2). With each film was included a cloth mailing bag, which gave

EXHIBIT 2
MINIMUM RESALE PRICES OF FILMS ESTABLISHED BY MANUFACTURERS UNDER THE FAIR TRADE LAWS

Size	Gevaert No.	Equivalent to Regular No.	List Price	Minimum Resale Price
1⅝" × 2½"	G27	127	25¢	23¢
2¼" × 3¼"	G20	120	30¢	27¢
2¼" × 3¼" thin metal spool	G6-20	620	30¢	27¢
2¼" × 4¼"	G16	116	35¢	32¢
2½" × 4¼" thin metal spool	G6-16	616	35¢	32¢

the purchaser an opportunity to mail the exposed film to a division of the company in New York and have it developed, printed, and returned to his home for 25 cents. This price was less than half the regular New England drug store price of 55 cents for developing and printing eight pictures. Directions were enclosed with each film, explaining the procedure to be followed in mailing and making payment (see Exhibits 3 and 3A).

The films were displayed on the counter in an open metal rack, which was supplied to Standard Brands by the Gevaert Company free of charge and lent to the grocer when he purchased his initial stock of films. The rack contained a section for each size of film and space at the top for a display card, which emphasized the low price of developing and printing. Two pictures were shown, one printed the size of the negative and one enlarged to the size furnished by Standard Brands. Company officials suggested that the grocer insert pictures of neighborhood interest to increase the effectiveness of the display.

In promoting the service the salesmen encountered some resistance among retail grocers. In the first place, the grocers did not

wish to invade the territory of the druggists; in many cases the drug stores were located next to the grocery stores, and the proprietors were personal friends. Secondly, since February was in the off

EXHIBIT 3
STANDARD BRANDS, INC.
Directions Enclosed with Film

AMAZING MONEY SAVING OFFER!
8 exposures, any size up to 2½″ × 4¼″, developed and enlarged to almost double the size of your negative for only 25¢.
Here's all you do after taking pictures:
1. Put your exposed film in the bag that comes with your roll of film.
2. Place 25¢ coin in the bag.
3. Tie string tightly. Use a double knot.
4. Print your name and address clearly in ink on side of tag marked "from."
5. Place 1½¢ postage on tag, drop bag into nearest mailbox or post office.

YOUR ENLARGED PRINTS WILL BE SENT
POSTPAID TO YOUR HOME
See Other Side for Price Schedule
STANBI PHOTO SERVICE
Gen. P. O. Box 398
New York City, N.Y.

EXHIBIT 3A
STANDARD BRANDS, INC.
Directions Enclosed with Film

PRICE SCHEDULE
SAVE THE BAG that comes with this film. Use it for mailing your exposed film for developing and enlarging, or use it for mailing any film that may be in your camera now. A new mailing bag comes with every roll of film purchased here.

All eight-exposed rolls, up to 2½″ × 4¼″ developed and enlarged to almost double size........25¢
(No extra charge for split rolls)
If all negatives are not printable refunds will be made as follows:
Less than 5 prints........refund 10¢
Less than 3 prints........refund 15¢
No prints........refund 15¢
All reprints same price as original order; minimum order eight for twenty-five cents.

ALL PRINTS AND NEGATIVES
RETURNED TO YOU POSTPAID
This wonderful service gives you LARGE PICTURES at a LOWER PRICE than you usually pay for small size.

season for the sale of films, the grocers objected to giving the display rack a prominent place on the counter; and they were loath to invest $7 in cash for the films needed to fill the rack. They pointed out, moreover, that because the rack was open the films might

easily be stolen. Some grocers thought that the 27% margin was too small, although they seldom were offered more than 33⅓% on a new item and received substantially lower margins for most of the merchandise in the store. There were several complaints about the obscurity of the brand name and the fact that the film carried the mark "Made in Belgium." This objection was expected to be only temporary, however, since the Gevaert Company was building a manufacturing plant in the United States. A few grocers mentioned the unsuitability of the product, at least during the introductory period, for telephone solicitation. Some objected because film was not available for very small cameras. Others anticipated a waste of time in complying with customers' requests to install the films in their cameras, as many druggists did. Finally, the salesmen discovered that a number of grocers were already handling film and had made arrangements with local companies to share with them the profit on developing and printing.

After the plan was started, however, the salesmen reported that the grocers found it convenient for their customers. Nevertheless, during the introductory period some complaints were received that the service was slower than the three days which the company had claimed in the beginning. On checking this matter, the division manager found that the films were being developed, printed, and mailed on the same day they were received in New York and that the delay came from the postal service. The films were mailed in both directions as second-class matter; and as a result, a week was often required for the pictures to be returned. The most surprising objection which arose during the trial period was that certain customers did not like the larger print because it did not match those which they already had in their albums.

The manager of the New England division had believed from the beginning that it would be impossible to sell the service to the large chains. In the first place, he thought that the chains would hesitate to enter the business because of the possibility of antagonizing the druggists. The chains for several years had maintained a policy of doing everything they could to retain the goodwill of as many groups of people as possible in the face of anti-chain store agitation. In the second place, the manager recognized that, if executives of any of the larger chains considered it worth while to sell film, they would almost surely establish their own developing and printing service. In fact, one of the largest chains in the

EXHIBIT 4
DIRECTIONS DISTRIBUTED WITH FILM BY A LARGE NEW ENGLAND GROCERY CHAIN

DEVELOPING AND PRINTING ANY SIZE ROLL
only 25¢ only
FOR 8 LARJA PRINTS
(8 ALMOST DOUBLE SIZE ENLARGEMENTS)

Save up to 50% of Cost of Your Regular Size Prints

You can save up to 50% or more in the cost of developing and printing this roll of film by merely placing the exposed film in the bag with a 25¢ piece and depositing the bag in any convenient mail box. You will then receive by mail, postage prepaid, 8 very fine quality Larja Prints. (All films are processed by the most modern and efficient methods known in the photo finishing industry.) Prints will be mailed back to you, postage prepaid, promptly and without delay.

DIRECTIONS FOR MAILING

1. Be sure to save the cloth bag and tag attached. Proper postage is already affixed.
2. Place exposed film in cloth bag with a 25¢ piece, draw string securely and knot tightly.
3. PRINT CLEARLY your name and address in INK on the side of the tag marked "From." Write nothing else on tag because further writing is against postal regulations. Deposit bag in mail box.

EXHIBIT 4A
DIRECTIONS DISTRIBUTED WITH FILM BY A LARGE NEW ENGLAND GROCERY CHAIN

DIRECT FROM PRODUCER TO YOU!
SPECIAL FEATURES

1. Quality work.
2. Direct from photo finisher to you.
3. "Middle Men" profits up to 40% eliminated.
4. No costly automobile pick-up or delivery costs—postage is less expensive.
5. Prices based on large volume—low overhead.
6. Larja prints almost double the size of your negative at no extra cost.
7. Efficient and prompt service by U.S. mail.
8. Save time—every mail box a convenient delivery station.
9. Postage prepaid both ways.
10. You save up to 50%.

COMPARE OUR PRICES
QUALITY PRINTS AT LOW COST

Eight prints nearly twice the size of negative, 25¢.
Reprints 3¢ each (no order under 10¢ accepted).
We refund to you if less than five pictures are printable.

4 prints	refund 3¢	2 prints	refund 9¢
3 prints	refund 6¢	1 print	refund 10¢

If all negatives are unprintable, we will mail to you postage prepaid a roll of film without further charge.

All Pictures will be Mailed Promptly and Without Delay!

FILMCRAFT
Incorporated
P. O. BOX 777—BOSTON, MASS.

New England area had been selling films since the summer of 1939. This company sold the Gevaert film and maintained a printing and developing service of the usual type in Boston. The Gevaert film was sold at the minimum resale price and was distinguished from the Standard Brands film only by the fact that the mailing bag and sheet of directions (see Exhibits 4 and 4A) were attached to the outside of the box with a rubber band, instead of being placed inside the box. Another difference was that the chain's mailing bag had a stamp already affixed, so that in effect the price was 1½ cents lower than that on the Standard Brands film.

Should Standard Brands, Inc., have extended the distribution of film to 4,000 stores in New England?

4. SKELTON NOVELTY COMPANY

SELLING TO WHOLESALERS AND CHAIN STORES

In October, 1937, the New York salesman of the Skelton Novelty Company asked the sales manager for permission to offer to buyers of limited-price variety chain stores of the F. W. Woolworth type a novelty key chain at a price of $4.25 a gross. In keeping with its general policy, the company had introduced this key chain two months previously through wholesalers at $5.75 a gross.

The Skelton Novelty Company, located in an industrial city in New Jersey, manufactured small articles of cast plastic,[1] largely of a novelty character, including, among others, ash trays, penholders, pen stands, calendar stands, watch chain charms, dice, and salt cellars. These products were distributed through wholesalers and chain stores, and because of their nature even the more successful items often lasted in the trade only a few months.

Among approximately 1,000 wholesalers to whom the company regularly sold its products were wholesalers of drug sundries,

[1] *Plastics* are substances made by chemical processes from raw materials which have properties altogether different from those of the finished product. Among the familiar trade names of plastics are Bakelite, Catalin, Plaskon, and Celluloid. The substance used by the Skelton Novelty Company was put into molds at the factory of the plastic manufacturer while in a sticky, liquid state. After solidifying, it was shipped to the plant of the Skelton Novelty Company, where it was cut or otherwise shaped into the desired forms and sizes and given the requisite designs.

stationery, notions, general merchandise, tobacco, hardware specialties, and novelties. These wholesalers, in turn, sold to a wide variety of retail outlets, including newsstands, tobacco shops, stationery stores, gift shops, hardware stores, and dry goods stores. Novelty goods wholesalers, the most important single group of wholesalers to the company, sold extensively to independent novelty stores and also to numerous other types of stores. The Skelton company sold direct to chain stores and to large operators of railroad and hotel newsstands. It employed five salesmen to cover all sections of the country except the South and had much wider coverage of the market than its competitors, who operated in restricted areas or sold only to large buyers.

Since the usual price which wholesalers paid for items retailing at 10 cents was $6.75 a gross, the $5.75 price for the novelty key chain allowed them a larger gross margin than was customary in the trade. Wholesalers sometimes shared this increased gross margin with retailers by reducing prices to them. The Skelton sales manager knew that wholesalers ordinarily sold 10-cent items to retailers at prices varying from $7.50 to $9 a gross. In most instances retailers paid the maximum amount for new novelty items. Variations in prices were caused largely by the frequent introduction of new products by manufacturers and the effects of this situation on established products sold by wholesalers.

The novelty key chain was made of metal links, with a single die attached. A few weeks after this item had been introduced at $5.75, the company developed a key chain with a die twice as large as that on the original chain to be sold to wholesalers at $6.75 a gross although production costs were substantially the same. The company had discovered that dice imperfect for sale in matched sets of dice, which it also sold, could be used as charms on both the original and the larger key chains. Although there were not enough rejected dice to supply all those needed, the saving in cost by using what would otherwise have been waste products was substantial. Sales of both sizes of key chains through wholesalers had been satisfactory.

The sales manager believed, on the basis of past experience, that sales of the $5.75 line of key chains to chain stores at $4.25 would increase volume to such an extent that aggregate net profit would be larger than that obtained from sales to wholesalers at $5.75. Unit production costs would be decreased by about 20% with the

larger volume because the key chains could be purchased more cheaply in greater quantities, and the cost of drilling the holes in the dice could be reduced somewhat. A slight saving would be possible, also, in mounting key chains on individual cards for chain stores rather than mounting 12 on one large card for counter display as was done for sales to wholesalers. The cost of the material in the dice, however, would not be reduced.

On the other hand, if the key chains were sold to chain stores, it was feared that the wholesale trade on this item might be lost because wholesalers usually refused to buy, at any price, an article to retail for 10 cents which chain stores were selling at 5 cents. Independent retailers could not meet this price because wholesalers would have to buy at $3.60 or less a gross in order to be in a position to offer them merchandise to sell at 5 cents. Variety chain store buyers refused to consider the key chain as an item to retail at 10 cents.

The Skelton Novelty Company relied on wholesalers in introducing new items. The sales manager believed that chain store buyers were interested only in established products. In the past, the company had designed similar but distinctive products for the chain stores when their buyers showed interest in established products, but had continued the old items in the wholesale trade. In one or two instances, an improved article was offered to both wholesalers and chain stores at the same price, while the old product was sold to the chain stores to retail at a lower price. The variety chain store buyer with whom the New York salesman was in touch wanted the exact key chains with dice that were already being sold to wholesalers at $5.75. Because of the nature of the product, technical improvements in a redesigned key chain for wholesalers did not seem possible.

The prospective profit on sales to chain stores at $4.25 a gross was very attractive to the sales manager. He considered it important, however, not to offend the wholesalers on whom the company had relied in introducing all new products. About 25% of the 1,000 wholesalers with whom the company dealt at one time or another were carrying the $5.75 line of key chains in the fall of 1937.

Should the sales manager have granted the New York salesman permission to offer the novelty key chain to buyers of limited-price variety stores at $4.25 per gross?

5. PENWICK COMPANY

EXCLUSIVE RETAIL AGENCY FOR GROCERIES

The Penwick Company operated a large retail and wholesale grocery business in Philadelphia. Although it sold a large quantity of staple merchandise, the company specialized in fancy and imported groceries distributed under its own brands. The traveling salesmen for the wholesale department covered the territory within a 300-mile radius of Philadelphia.

In 1937, J. K. Lawson, who operated a retail grocery store in New Jersey, requested the Penwick Company to grant him an exclusive agency for its merchandise in his town. The resident population of the town was 2,200; but during the summer months, the population was increased by an influx of more than 1,000 people from Philadelphia, New York, and other cities. These summer visitors were people of fairly high income, and many of them owned cottages or summer homes in the town. Others registered at the large summer hotel. In addition to the Lawson store, there were three other independent grocery stores, all of which were less attractive in appearance and poorer credit risks. The Lawson store was unquestionably the most enterprising and successful grocery store in the town.

The Penwick Company had previously sold to all four stores and also to the hotel. Furthermore, the retail branch of the company had shipped mail orders by express direct to consumers in the town. Other wholesale grocers in Philadelphia and New York regularly competed for orders from the retailers and the hotel.

The Penwick Company had never granted exclusive agencies. If Mr. Lawson's request were allowed, the agency would last for an indefinite period, which might be terminated by either party. The Penwick Company, moreover, would not be obliged to discontinue its sales either to the hotel or direct to consumers.

Should the Penwick Company have granted Mr. Lawson's request for an exclusive agency?

6. WILLIAMSON COMPANY

SELECTED RETAIL DISTRIBUTION FOR STERLING SILVER

In the fall of 1934 the manager of the Horton Company, a retail jewelry store located in an eastern city with a population of 150,000, asked the sales manager of the Williamson Company, a well-established manufacturer of sterling silver flatware and hollow ware, to allow his store to sell the Williamson line of sterling silver products. The sales manager of the Williamson Company was not certain what action he should take, because he did not know how the operators of the two leading jewelry stores in that city, which already purchased from the company, would react if a third store were allowed to sell the products of the Williamson Company. Three possible solutions occurred to the sales manager: he might sell the company's full line to all three stores; he might grant the two stores which already sold the company's merchandise exclusive rights to certain patterns, and allow all three stores to sell any of the other patterns; or he might refuse the request of the Horton Company.

The Williamson Company adjusted its distribution according to the size of a city and the type of jewelry stores located in it. In large metropolitan cities the company usually sold to all the leading jewelry stores which desired to carry its products. It was careful, however, to discontinue selling to stores which did not maintain the suggested retail prices on its merchandise, or to stores against which the important jewelry retailers were prejudiced. For that reason the company ordinarily did not sell to department stores, since their selling methods often antagonized the jewelers. In one metropolitan center, for instance, the company did not sell to the leading department store because the three large retail jewelers in that city refused to sell the Williamson line of silver if the department store also displayed it. In Chicago, on the other hand, the outstanding department store had established such an excellent reputation for its jewelry department that the leading jewelry stores had no objection to its carrying Williamson silver. New York presented still a different situation since the leading jewelry stores there manufactured their own silverware. For this reason the Williamson Company found that department stores furnished the best outlet for its products in that city.

The medium-size cities, according to the sales manager of the company, were divided into two groups. In one group of cities, such as Kansas City, Missouri, and Springfield, Massachusetts, there was only one important jewelry store; in these cities the Williamson Company sold only to this store. The cities in the second group, including Indianapolis, Indiana, and Hartford, Connecticut, had two or more jewelry stores of nearly equal importance, all of which the company desired to supply with its merchandise.

In the smaller cities, such as Burlington, Vermont, Madison, Wisconsin, and Sioux City, Iowa, where for the most part there was but one jewelry store of any importance, the company sold only to the outstanding jeweler.

The Williamson Company had very little representation in the smaller communities[1] of the country, because there were but few sales of sterling silverware in such places. Most of these towns had one or more small jewelry stores and watch-repair shops, which sold as side lines such articles as lamps, gifts, and a small quantity of silver-plated ware but almost no sterling silver. In these communities the few people who could afford sterling preferred, when they were making an important purchase, to buy in a larger city rather than at home. There were, however, certain exceptions to this practice, especially in southern towns, where sterling silver was generally more popular than in the localities of comparable size in other parts of the United States. The entire volume of sterling silver business in the United States was not large in comparison with other industries of a luxury character.

In most cities the company did not give individual retailers exclusive sales rights to any of the 24 patterns of flatware or the numerous patterns of hollow ware which it manufactured. The officers of the company believed that, since there was relatively little duplication in customers among stores in one city, a particular store was not harmed if other stores sold the same patterns. To prove this fact, the company checked the lists of regular customers of the two leading jewelry stores in a medium-size city and discovered, much to the astonishment of the owners of those stores, that there was a duplication of only 20% between the two lists. In a few cities, however, the company divided its patterns among

[1] An officer of the company stated that it was impossible to classify cities by census count since there were substantial differences in the trading areas served by cities of equal size, and also wide variances in the popularity of sterling silver products among such cities.

dealers when individual retailers refused to sell the company's line unless they received exclusive rights to the sale of certain patterns.

Most of the jewelry stores in large and medium-size cities sold the merchandise of a number of different manufacturers of silverware, and frequently carried as many as six to twelve patterns made by one concern. In the smaller cities the jewelry stores more often sold silverware made by one, two, or three companies, and carried only from three to six of the leading company's patterns.

Although several manufacturers of silverware required their customers to purchase a certain amount from them in order to have the privilege of carrying their lines, the Williamson Company made no such stipulation. Thus, many jewelry stores carried in their inventory several hundred dollars' worth of the company's more popular patterns and a few sample pieces of a number of other patterns. Surveys indicated that among larger jewelry stores sales of sterling silver frequently amounted to 20% or more of total volume.

For many years the Williamson Company had been represented in the eastern city where the Horton Company was located by the two leading jewelry stores of the city. Both these stores had well-established clienteles and had given aggressive support to the company's merchandise. The Horton Company had been in existence for a much shorter time than the other two stores. This store, however, was operated by men who were familiar with the jewelry trade and who had developed a reputation for reliability and good character. These men were young, energetic, and aggressive and were building a good name for the store. At the time when the manager wrote to the Williamson Company, the store was selling silverware produced by several other leading manufacturers.

In deciding whether to allow the Horton store to sell the company's silverware, the sales manager of the Williamson Company considered the effect which the granting of such permission would have on the company's sales to the other two stores in the city. He wondered whether these other stores would tend to neglect the company's line either temporarily or permanently. The sales manager analyzed the company's sales to these stores, and found that each of them had made large annual sales of two or three patterns but had sold very few pieces in most of the company's other patterns.

Should the Williamson Company have granted the Horton Company's request?

7. LOMBARDY COMPANY

EXCLUSIVE WHOLESALE AGENCY FOR GROCERY PRODUCT

A new baking powder was put on the market by the Lombardy Company, which had long been engaged in the manufacture of products other than foodstuffs. During the first two years, the sale of the product was confined to the territory immediately contiguous to New York City. The officers did not plan to advertise the baking powder nationally until the company had established distribution outlets throughout the country. When the company was ready to undertake a program of gradual sales expansion, however, one of the first questions before the management was how to secure initial distribution in the Middle West and on the Pacific Coast.

Many wholesalers, particularly the large concerns, had private brands of baking powder; and it was therefore expected that they would be reluctant to push Lombardy baking powder, even though the retail and wholesale prices of the Lombardy product were fixed so as to yield ample margins of profit.

The Lombardy Company approached the Mendota Company, one of the largest firms of wholesale grocers in Chicago, with a proposal that the Mendota Company act as the sole distributor for Lombardy baking powder in the Chicago territory. Although the manufacturing capacity of the Lombardy Company was limited at the time, the officers pointed out that as soon as the company could produce more baking powder than the wholesaler could sell, they intended to seek additional outlets in St. Paul, Omaha, St. Louis, and other cities, and that eventually the product would probably be sold to all wholesale grocers. Therefore they specified that the sole distributorship might be terminated by either party. No other conditions were stipulated by the Lombardy Company.

The Mendota Company employed 124 traveling salesmen. It not only carried practically all the staple brands of food products but had also developed its private brand in numerous lines, including canned goods, tea, and coffee, but not baking powder.

The salesmen of the Mendota Company covered intensively the territory within 300 miles of Chicago. Its specialties under private brands were sold in regions beyond this 300-mile radius.

Should the Mendota Company have accepted the offer?

8. HOMER FOOD COMPANY

OFF-CAR SELLING BY MISSIONARY SALESMEN

Early in 1940, the general manager of the Homer Food Company was considering the possibility of changing the form of distribution used in the three districts outside New England, where the company's main office was located. He believed that, in certain large markets, "off-car" selling might be replaced by a more efficient method; and he suggested that the Detroit territory be used as a basis for discussion and as a testing ground for any new system which might be proposed.

The Homer Food Company manufactured a single product in two grades, which were both available in 8-ounce, 1-pound, 1½-pound, and 2-pound packages, as well as in three types of individual-serving packages. The company's brand name had been advertised for many years in newspapers and magazines and on billboards, until the product had become one of the best known in its line.

In the New England territory the company for many years had employed salesmen to sell direct to retail stores. Wholesalers' business also was solicited; but because sales made by company salesmen were not routed through this channel, the wholesale volume had declined, until in 1939 it had amounted to only 20.6% of the total as compared with 55.8% for independent retailers and 23.6% for chains. In this district, the company maintained one schedule of prices for all classes of customers—wholesalers, retailers, or consumers. For single orders of one grade of the product, the 1-pound package was priced as follows:

Number of Packages	Price per Package
Less than 12	53 cents
12–99	51
100 or More	48

In the other three divisions, New York, Detroit, and Chicago, the company used a completely different method of distribution. In the Detroit district, for instance, under the control of the resident division manager there were 17 salesmen, 5 in the city of Detroit and 12 in the rest of the territory, who took orders from wholesalers for shipment from the company's factory. These orders were generally for 100 pounds or more. This same group of salesmen usually spent five days a week visiting the retail food stores in the area, making about 40 calls a day in the city and from 25 to 30 in the outlying districts. Instead of soliciting orders for delivery direct from a company warehouse, however, the Detroit salesmen acted almost as missionary salesmen.[1] Their procedure was to purchase a supply of the product from one of the wholesalers, deliver it direct from their cars to the shelves of the retail stores, and collect cash for the transactions. If a customer could purchase 100 pounds or more at a time, however, his order was shipped direct from the warehouse and he was billed as though he were a wholesaler. In selecting the wholesaler from whom to purchase his stock, a salesman was influenced by the location of the territory to be served and, in the case of the Detroit metropolitan area, where 40 wholesalers handled the product, by his desire to maintain the goodwill of all.

To enable the salesmen to purchase a supply of the product before receiving orders from retailers, the company advanced them from $200 to $250 each. By paying cash to the wholesaler, the salesmen could obtain the product at a lower price. For example, if the price to the wholesaler of a particular grade in 100-pound lots was 48 cents a pound and his regular resale price to retailers was 53 cents, the company salesmen were able to buy at 50 cents because the wholesaler had no selling expense and because the transaction was on a cash basis. The salesmen then resold the product at the same price as paid to the wholesaler, in this case 50 cents a pound. If a store wished to buy on credit, the salesmen treated the order as a regular wholesale transaction and transmitted it to the wholesaler to be delivered by him at his usual resale price.

About half the sales of the Homer product to retailers in the Detroit district were made by company salesmen in the manner described above. The rest were made by wholesalers, either

[1] For a description of the work of missionary salesmen, see the case of the Larmon Company, p. 326, below.

because the stores wanted credit or because their stocks ran low between salesmen's visits. The Homer salesmen generally called on a retailer once in every five or six weeks.

The off-car selling plan had several advantages which had led a number of food manufacturers to adopt it. In the first place, in delivering the product direct to the dealers' shelves, the company salesman obtained an opportunity to set up an attractive display and to place advertising material where it would be most effective. He also could attach the price tickets to the product, thus insuring that the Homer brand would be sold at a price in line with prices of competing brands. A further advantage of this type of selling was the fact that the retailer paid less for the product than he would ordinarily pay the wholesaler; therefore he could resell it at a correspondingly lower price. Another important reason for continuing off-car selling was the fact that it had gained the wholesalers' goodwill and assured the company of their complete cooperation. The wholesalers, almost without exception, appreciated the fact that the company was bearing the selling cost of about half their volume in the Homer product and that the markup which they obtained, although small, was chiefly net profit.

On the other hand, the general manager of the Homer Food Company recognized that there were certain drawbacks to this type of selling. The chief disadvantage was the possibility of selling only a small quantity for cash. The management believed that the dealers should be encouraged to carry a complete assortment of the product; but this required a cash outlay of $15 to $25, and the average grocer was not in a position to pay out this amount of cash over the counter whenever the company salesman happened to arrive. Another disadvantage was the infrequency of the salesmen's visits. Dealers' displays were not renewed between calls, and stocks became low; ordinarily the grocer hesitated to replenish his stock direct from the wholesaler, because he was required to pay more for it. Finally, the general manager believed that the cash advances to company salesmen might easily have a bad effect; a man might be tempted to use the money for his own needs and then have difficulty in repaying it.

According to the general manager, there were at least four courses of action open to the company. One was to sell to wholesalers and perform the usual missionary work of taking orders to be delivered by them. This plan would involve fully as high sales

expense, and the salesmen would not have an opportunity to arrange the merchandise when it was delivered to the store. Moreover, the price which the retailers paid would necessarily be higher. A second possibility was to sell to wholesalers and rely on them to undertake the promotion of the product through their own salesmen. This plan was not deemed advisable, however, because the wholesalers' salesmen carried so many items that the Homer product might be overlooked unless the retailers demanded it. Another possibility was to have the company salesmen take delivery from a public warehouse in order to avoid paying the wholesalers' markup. The management knew that storage charges would be considerably less than the amount of this markup. This plan, however, would incur the ill will of the wholesalers. Lastly, the company had the option of opening a sales branch in Detroit to carry a stock of merchandise from which the salesmen could take delivery. This plan, like that for the use of a public warehouse, had the disadvantage of alienating the wholesalers; and unless the company employed substantially more salesmen to call on retailers, the necessity for the latter to place orders between visits could probably not be avoided. The Homer company had once used a branch house in New York, but this system of operation had proved to be very expensive because unit sales to retailers in that city were so small. The general manager was convinced that in the Detroit area, likewise, the retailers' long-standing habit of purchasing their supplies in small quantities would prevent any sizable increase in the average order.

Should the Homer Food Company have discontinued off-car selling? Should the company have continued to use missionary salesmen regularly?

9. SECOY COMPANY

DISTRIBUTION CHANNELS FOR OIL BURNERS

In 1938 the executives of the Secoy Company were thoroughly dissatisfied with the results of the company's efforts to market an oil burner. A new sales manager undertook a survey of the company's policies with the objective of securing more satisfactory channels and developing more effective promotional methods.

The Secoy Company, an old Philadelphia firm with ample financial resources, for many years had manufactured high-grade plumbing fittings and supplies, which were sold by a small salesforce to plumbing supply firms for redistribution to plumbers and steam fitters. In this market the company enjoyed an excellent reputation for high-quality merchandise. Early in the development of oil burning equipment for household use the company had designed and patented a pressure-atomizing type of burner, commonly known as the "gun type." Since the company had a reputation for high-quality products, no expense was spared in making a correspondingly good burner. In common with most manufacturers of oil burners, the company purchased a majority of the parts used, although it manufactured the distinctive patented parts. Because the manufacturing process was so largely one of assembly, overhead charges were low; and the company showed a profit even on a volume as low as 500 units a year. Originally the Secoy burner had been sold at an installed price of $600. By 1935, however, this price had been reduced to $325.

The Secoy Company distributed its plumbing fixtures and supplies on a national scale through some 500 plumbing supply houses scattered throughout the United States. From the outset the company had endeavored to use these same outlets for the distribution of its oil burners. It had never succeeded, however, in inducing all its supply firms to carry the oil burners. Some concerns, of course, were located in territories which were poor markets for oil burners. Even in more promising territories, however, many plumbing supply firms were unwilling to carry the oil burners, and others gave the Secoy Company only sporadic support. Most of the plumbing supply firms handling the Secoy burner had not pushed the sale of burners. They ordinarily sold one only when a customer asked for it. The experience of the Secoy Company apparently was similar in part to that of other manufacturers; for according to a survey[1] conducted by a trade journal, plumbing and heating wholesalers had not been wholly successful outlets for the oil burner manufacturers because such concerns had not been set up to do a specialty selling job. Since 1932, however, this survey stated that there had been a marked trend on the part of these wholesalers to take on lines of oil burning

[1] "Oil Burner Selling," published by *Automatic Heat and Air Conditioning* (Chicago, 1937).

equipment. This development was attributed to the fact that automatic heat, air conditioning, and straight heating were, for all practical purposes, one and the same industry; and in order to protect their business, the plumbing and heating wholesalers to an increasing extent had found it necessary to establish separate departments to handle such specialties.

The management of the Secoy Company itself had not been particularly energetic in pushing the oil burners. The only promotion which it gave them was a few pages in the company's catalogue. Furthermore, the management had not urged the salesmen to devote special attention to the burners. The salesmen received no additional compensation for making sales of burners, nor were they given credit for initiative when they did achieve a satisfactory sales record.

The new sales manager summarized the history of oil burner selling and the existing competitive situation in the sale of oil burners as follows.

The growth of industry sales had been as shown in Exhibit 1. According to the pamphlet "Oil Burner Selling," poor equipment had caused a marked reaction on the part of the buying public in 1925, 1926, and 1927. Early manufacturers had looked to the

EXHIBIT 1
ESTIMATES OF OIL BURNER SHIPMENTS, 1921–1936

Year	Number of Burners	Year	Number of Burners
1921	9,000	1929	130,306
1922	35,300	1930	124,785
1923	43,000	1931	98,059
1924	79,700	1932	76,306
1925	45,200	1933	101,893
1926	77,700	1934	114,423
1927	82,700	1935	161,510
1928	107,500	1936	228,927

Source: Estimates based on U.S. Department of Commerce and Oil Burner Institute figures, as reproduced in "Oil Burner Selling," published by *Automatic Heat and Air Conditioning* (Chicago, 1937), pp. 6 and 7.

plumbing and heating contractors as their logical retail outlets and had made most of their sales through them. As the industry had progressed, however, the number of plumbing and heating contractors of the specialty-selling type had proved to be insufficient to afford all manufacturers adequate distribution. To meet this situation several manufacturers had inaugurated a policy of granting

exclusive distributorships for comparatively large territories or establishing factory branches to handle wholesale and retail sales. In many instances these distributors were organizations or individuals with specialty-selling experience but no experience in selling heating equipment. Although these outlets were satisfactory for a short time, the manufacturers soon found that some of the exclusive wholesalers were having difficulty in holding their organizations together during the off season. During these early years, prices remained in the vicinity of $600 for the size of burner needed in the average house. Gradually the specialized oil burner distributors and the factory branches added related merchandise, such as boilers and other heating equipment, in order to spread their overhead over a greater number of items. This equipment previously had been sold chiefly by steam fitters and plumbers. Manufacturers also turned to specialty sales organizations handling electrical appliances, radios, and refrigerators. Meanwhile, the introduction of the oil burning boiler in 1928 had occasioned further changes in distribution methods. The specialty sales organizations which were not in the heating business found it necessary, in many instances, to open heating departments in order to compete successfully. Some of the specialty sales organizations which had not become heating contractors were forced out of the business and were replaced by a growing number of heating contractors who had entered the specialty-selling field after 1925.

The fuel oil companies had also become a significant factor in the retail competitive situation. The interest of the fuel oil firms naturally lay in the sales of fuel oil. These companies believed that they could materially increase profits on fuel oil by enlarging the number of fuel oil users. In the early days of the oil burner business, some fuel oil companies had paid oil burner salesmen $2 for each 2,000-gallon contract which they had been able to secure at the time of the installation of the burner. As a result of competition, this payment had gradually risen to a figure as high as $10 per 2,000-gallon contract. Since most fuel oil companies used similar methods, no one concern could be sure of receiving the oil contract. Consequently, many fuel oil companies had begun to sell oil burners as a means of securing the contracts. The sales manager of the Secoy Company was confident that many of the oil companies sold burners at prices only slightly above their purchase and installation costs for the sake of the profits on oil.

According to the survey "Oil Burner Selling," practical experience had shown these fuel oil dealers that selling oil and selling oil burners were two different businesses. Hence, most of those dealers who were successfully selling oil burners carried on this business through an entirely separate department. Since the oil burner business had become an automatic heat and air conditioning business, these departments required men specially trained in heating as well as in combustion service.

The estimated distribution, by the principal business of the dealer, of total oil burner sales for the three years 1935, 1936, and 1937 was as shown in Exhibit 2.

EXHIBIT 2

ESTIMATED DISTRIBUTION OF RETAIL SALES OF OIL BURNERS CLASSIFIED BY PRINCIPAL BUSINESS OF DEALER

Classification	Percentage of Total Industry Sales		
	1935	1936	1937
Oil Burner Dealers	22.50	19.33	20.79
Plumbing and Heating Contractors	24.65	22.84	18.26
Hardware Dealers	10.00	6.38	11.60
Automatic Heat and Air Conditioning	3.46	7.04	10.97
Electrical Contractors	4.25	4.95	7.52
Warm Air and Sheet Metal Contractors	4.60	5.75	5.25
Electrical Appliance Dealers	5.44	4.80	3.76
Fuel Oil Dealers	3.30	4.46	2.99
Refrigeration Dealers	3.25	6.23	2.99
Oil and Coal Dealers	4.81	2.56	2.80
Automobile and Accessory Dealers	2.09	2.24	2.44
Building Supply and Lumber Dealers	1.26	0.80	1.76
Radio Dealers	1.50	1.60	1.27
Department Stores	1.34	0.80	1.18
Furniture Dealers	1.74	0.64	1.18
Domestic Appliance Dealers	1.26	1.60	1.09
Stoker Dealers	0.39	0.80	0.99
Manufacturers' Agents	0.66	0.96	0.50
Stove and Furnace Dealers	0.26	1.27	0.45
Machine Shops	0.49	0.32	0.32
Farm Implement Dealers	0.24	0.16	0.23
General Building Contractors	......	......	0.23
Bottled Gas Dealers	......	......	0.14
Gas Appliance Dealers	0.20	0.47	0.05
Gas Heating Dealers	......	......	0.05
Miscellaneous	2.31	4.00	1.19
Total	100.00	100.00	100.00

Source: "Oil Burner Selling," published by *Automatic Heat and Air Conditioning* (Chicago, 1937), p. 15.

In 1938 the price of Secoy burners for the average home installation was $325, whereas the prices of some burners sold by oil refiners, oil distributors, steam fitters, and plumbers were as low as $195. Some of these burners were equal in performance and durability to the Secoy burner. A few advertised brands of oil burners were sold in the same price range as the Secoy burner, which was unadvertised so far as the consumer was concerned. Both nationally advertised and relatively unknown brands were being sold at the $195 price. Some of the companies which made advertised burners selling at higher prices also supplied burners to oil companies and other so-called price cutters, but usually under private brands or unadvertised brands of the manufacturer. These manufacturers made sales to customers who competed directly with their own factory branches or with their exclusive dealers on advertised brands. A typical breakdown of the $195 price was as follows:

Price Charged by Manufacturers of Burner:	
In Lots of 100 (including controls)	$75.00
In Small Lots	90.00
Installation Cost (including tank, piping, labor, and one year's service)	75.00
Commission to Dealer's Salesman, 10% of Sales	19.50
Available for Overhead of Dealer and Profit	25.50

The sales manager had learned that over half the burners sold in the United States had been handled by dealers who installed six burners or fewer a year. Because of lack of training and experience, moreover, these small dealers, plumbers, or steam fitters were the least suited for either personal selling or installation of burners.

In view of the foregoing facts, the Secoy sales manager proposed that the company abandon the use of plumbing supply firms as major outlets for oil burners. Until this time the Secoy Company had taken no interest in retail distribution, and the plumbing supply firms had been free to sell to whoever would buy. As indicated earlier, their sales effort was intermittent and on the whole unsuccessful. Under the proposed plan the Secoy Company would seek steam fitters, plumbers, and certain types of fuel companies as outlets to sell the Secoy burner at an installed price of $250. This was to be the same burner that had formerly sold for $325. The retail dealer was to pay the distributor $125 for the burner, and the distributor was to pay the company $105. No quantity discounts would be given. To compensate for the high price paid

by the dealer, the sales manager planned a sales and engineering program to assist dealers and distributors. He expected to appoint distributors who would establish service and installation crews to handle such work for all dealers in their territories. These distributors were also to sell oil burners at retail.

One test to be applied in the selection of retail outlets was whether the outlet really needed a program of sales cooperation in order to maintain its existence. The steam fitter, for instance, needed an oil burner to meet the competition mentioned above. With this class of customer, moreover, the name Secoy already had a reputation of quality and dependability. Many steam fitters and plumbers had little sales ability and did no advertising other than an occasional distribution of cards or insertion of their names in a newspaper; but they did have contacts based on the word-of-mouth advertising of satisfied customers. The sales manager believed that it made little difference whether such companies had offices in shops or at the homes of the proprietors. Their opportunity to make sales seemed to depend largely on their personal contacts and ability to render satisfactory service on short notice. These concerns, however, were not expected to be able to maintain either a service or an installation crew. This work would be done by the distributors. The sales manager planned to sell to as many of these plumbers and steam fitters as could be induced to buy.

The sales manager believed that coal companies also were logical prospects for the Secoy burner. Many coal companies had added oil departments to offset the decline in sales of coal. Some of these concerns had not obtained the fuel business which followed the sale of burners, and therefore had added burners. Others had not added burners because of the high cost of maintaining a service and installation staff. Here again, the sales manager thought that his plan of handling service and installation through the distributor would be helpful.

Hardware stores and specialty appliance shops were rejected as possible outlets, because they divided their interest among too many items.

The sales manager proposed to establish one or two distributors in each metropolitan market. He recognized that in 1938 there was no clearly defined wholesaler in the oil burner field. Moreover, the company had not been satisfied with the results of its experience with plumbing and heating supply wholesalers. It had not tried,

however, to use distributors whose primary business was the sale of oil burners or household equipment. The sales manager did not have a particular type of wholesaler in mind, although he had defined what he wished the distributors to do for the Secoy Company. Such firms would organize crews of two or three full-time men to handle the installation and servicing for all retail representatives in their territories. The cost of such a crew was estimated to range from $3,000 to $5,000 annually. The dealer who paid $125 for a burner would pay the distributor an additional fee of $65 for the installation; and out of the suggested retail price of $250 he would have $60 for sales commissions, overhead, and profit. The consumer would thus be assured of reliable installation and service, and the company expected to be able to obtain maximum exposure of its product to sale. The $65 received by the distributor was over and above the $20 margin granted him as distributor. For this latter margin he was expected to carry a minimum of three burners in stock, to handle sales training for small dealers, and to help the manufacturer select dealers and sell them the initial order. In smaller cities, where total sales would not justify the $3,000 to $5,000 annual cost of an installation and service organization, the sales manager proposed to have a distributor who would serve several towns.

For each territory, the sales manager would attempt to find distributors who would agree to perform the services outlined above. He expected that many distributors would sell direct to consumers in addition to making sales to other dealers or subdealers. When territories were large enough, it was hoped that distributors would restrict their activities to wholesaling in order that they might not be competing with their retail outlets. The sales manager was willing to appoint as wholesale distributor an existing retail dealer or contractor if he handled all types of automatic heat and air conditioning equipment.

As additional helps for dealers and distributors, the sales manager proposed to prepare a sales manual which would offer suggestions on how to sell and explain how to make a survey to determine what type of burner to install. There was to be no consumer advertising of any type, except a booklet telling about the company and the product. The dealer was to be the main source of contact between the company and the householder. Competitors were thought to rely on price cutting, newspaper advertising, direct-mail litera-

ture, and "C" dealers for promotional aids. A drug store proprietor who overheard a customer say he was interested in an oil burner might become a "C" dealer; for half a salesman's commission on a completed sale this type of dealer supplied burner salesmen with contacts. A few competitors at times used house-to-house solicitation to find prospects.

In laying out his marketing plans the sales manager had access to a consumer survey made by a noncompetitive organization. Although there was some doubt as to the statistical validity of the sample, the sales manager considered the information contained in the survey useful if not given undue weight. In this survey, householders with oil burners in use listed the following advantages of heating with oil: there was no bother, the house was cleaner, and there was an even heat. Only 21% of the people interviewed had any complaints to make against oil heating, the principal one being trouble with burners. The sales manager believed, therefore, that provision for adequate service and responsible installation was important. The surveys also showed that 35% of the consumers were willing to buy oil distributed by any reliable concern; 34%, oil recommended by the burner manufacturer; 17%, oil purchased on the basis of brand of a reliable oil company; and 14%, the cheapest oil available. Another inquiry among owners of better-class homes who did not have burners in use showed that the principal reasons why these consumers had not purchased oil burning equipment were as follows: 47% thought that the cost of equipment was too high; 27% were waiting for better burners and lower prices; and 10% believed that the cost of fuel was too high.

If his program was accepted, the sales manager proposed to start sales activities in several eastern Pennsylvania counties and in Camden and Atlantic counties in New Jersey. If successful in these areas, he planned to expand activities into other sections of the state and nation. He estimated that the total sales cost, including sales, clerical, and executive salaries, and promotional literature, for the development of this first territory under the proposed plan would be $18,000. With a gross margin of $23 a burner for the Secoy Company, it would be necessary to sell nearly 785 burners to break even. In order to attain a net profit of $5 a burner, which the executives desired, sales of 1,000 burners would be needed. This latter figure was equal to the company's national sales of the previous year. According to the *Census of Population*,

1930, there were more than 370,000 owner-occupied dwellings with a value in excess of $3,000 in Philadelphia, Lancaster, Lebanon, Chester, Delaware, Northampton, Lehigh, and Montgomery counties in Pennsylvania and in Camden and Atlantic counties of New Jersey. Of these 370,000 homes, 20% were estimated to have oil burners in use. The sales manager believed that a substantial market remained to be developed. He stated that sales to contractors or others for new houses usually were about 20% of the total and that 80% of sales represented installations in dwellings already in use.

Should the proposals of the sales manager have been adopted?

10. NORGE CORPORATION

RELATIONS WITH DISTRIBUTORS

The Norge Corporation and its subsidiary, the Detroit Gear and Machine Company, were merged with the Borg-Warner Corporation in 1929; and with the financial assistance of the latter organization, national distribution of Norge domestic refrigerators was undertaken in 1930. Between 1930 and 1936, the company introduced the following products under the Norge name: commercial refrigerating units, washing machines, ironing machines, ranges (gas and electric), air conditioning equipment, and heating equipment. Prices of Norge products were directly competitive with those of the leading brands of similar products.

In 1936 there were 62 distributors[1] associated with the Norge organization. Of this number, 10 were hardware wholesalers; 1 was a furniture wholesaler and retailer; 16 were automotive parts wholesalers; 15 were wholesale distributors of radios and radio supplies; 5 were manufacturers of miscellaneous items noncompetitive with Norge products; 10 were plumbing and heating wholesalers, of whom 6 handled a general line of products of this class, 3 sold heating equipment, and 1 plumbing equipment; and 5 were wholesalers of miscellaneous products. All distributors handling other products maintained a separate division to sell the Norge line.

[1] Data on number of dealers and distributors have been modified by a constant percentage in order to protect the company.

Distributors employed approximately 600 wholesale salesmen who called on retail dealers. There were more than 6,000 retail dealers and approximately 11,000 retail salesmen. Nearly all the 6,000 dealers sold household refrigerators, and approximately 3,500 sold Norge washers. Dealers were divided into the following classifications:

Electrical Dealers	14.0%
Refrigerator Specialists	8.3
Department Stores	8.8
Furniture Stores	16.0
Jewelry Stores	1.0
Music Stores	7.0
Radio Stores	7.0
Light and Power Companies	1.6
General Merchandise Stores	1.6
Hardware Stores	5.3
Plumbing and Heating Stores	1.3
Lumber Companies	0.3
Garages	1.8
Automobile Dealers	2.6
Coal or Oil Dealers	0.8
Drug Stores	1.0
Miscellaneous or Not Classified	21.6
Total	100.0%

These percentages were based not on the number of stores in each group but on the units sold by stores in each classification. Several dealers were located in each of the larger cities in the country, and usually not more than one in small cities and towns.

In selecting a distributor the executives of the Norge Corporation were guided by the financial record of the prospective distributor as measured by operating statements, balance sheets, and credit reports, and by the general character and reputation of the company in its previous experience. Great weight was given to the character, integrity, and experience of the men guiding the prospective distributorship. Some attention was also given to the experience of the organization in the field of specialty merchandising.

The Norge field staff was organized on a line and staff basis. Reporting to the general sales manager were five staff sales managers in charge of marketing plans for different products, and nine district managers, who were responsible for factory-distributor relations on all products. Each staff sales manager had the field assistance

of "product" men who, nevertheless, were under the line control of the district managers. The district managers, for instance, solicited and received orders from distributors. The product specialists did not perform these duties. In general, the function of the product man or specialist was to promote better understanding of his product among the distributors' salesmen and to aid the distributors' salesmen in their calls upon prospective dealers and existing dealers. Cooperating with the efforts of these field representatives in their work of helping distributors to obtain new retail outlets and strengthen old ones, the company sponsored promotional campaigns for distributors, by offering prizes for good performance and awards for the appointment of new dealers, and engaged in other similar promotional activities.

The executives of the Norge Corporation endeavored to maintain a close control over the activities of distributors through a series of reports rendered to the factory executives by the distributors. Semimonthly, distributors reported to the home office sales to dealers by types and units. Copies of these reports were also referred to the district sales managers. Distributors likewise filed weekly and monthly inventory reports, and were required to keep the central office posted on the appointment of new dealers and additions to and removals from the number of dealer salesmen and distributor salesmen. The central accounting department of the Norge Corporation requested that dealers furnish monthly financial statements. Some distributors were unwilling to supply information of this character, and others found it difficult to obtain this information from their dealers so frequently. Typically, distributors themselves furnished monthly balance sheets and quarterly operating statements.

The factory sold refrigerators to distributors on a C.O.D. basis. The other Norge products were sold on terms of net, the twentieth of the following month. The distributors generally sold to dealers on the same terms. Dealers were assisted in financing their purchases by a uniform financing plan arranged by the Norge Corporation. It was necessary for distributors, however, to finance their purchases from the factory by making their own arrangements with banks.

In 1936, as a modification of the usual type of annual sales conference, the following program was adopted. Instead of meeting in conjunction with all the other distributors, each distributor

attended an individual conference with factory executives. An entire floor of a hotel in Detroit was rented, and displays of Norge products were arranged in different rooms, one room being reserved entirely for refrigerators, another for gas and electric ranges, a third for washers, and so on. The distributors, accompanied by key salesmen or product specialists, came in one at a time. On arrival the distributor first went into conference with the vice president in charge of sales, to whom he explained all the problems arising out of his experience with Norge products for the previous year. He was then turned over to product specialists, spending half a day on each product. The entire program was as follows:

One-half day—Executive session with vice president in charge of sales
One-half day—Product discussion, refrigeration
One-half day—Product discussion, gas and electric ranges
One-half day—Product discussion, washers and ironers
One-half day—Product discussion, commercial refrigeration, heating and air conditioning, space heaters
One-half day—Credit and finance plans
One-half day—Advertising and sales promotion plans
One-half day—Final executive session and agreement on 1937 program and quota
Total —Four days

Each year, the Norge Corporation established sales quotas for its distributors and dealers. In the fall of 1936, when the sales executives of the Norge Corporation were setting 1937 sales quotas for distributors, one of the executives suggested the the company give up its existing method of determining quotas for distributors in a conference of members of the sales department, and adhere, instead, to a mechanical allotment to distributors of expected total sales. The allotment would be made in accordance with the Buying Power Index of the International Magazine Company, which purported to measure the buying power of various trading areas.[1] Consideration of this proposal was deferred, and the 1937 quotas were set, as usual, in the following way.

The first step in preparing sales quotas for distributors was to estimate the total expected volume in units for each product. The vice president in charge of sales, the general sales manager, each product sales manager, and the sales statistician met together to

[1] See Appendix, p. 212.

consider the past sales record for a product, all that was known of the industry's total unit volume, and information about competitors' volume and plans. In the light of changes in the product, business conditions, and other factors, this group of executives reached a tentative agreement on the estimated sales for each product for the coming year. Thus, the 1937 domestic sales quota for refrigerators was set at 330,000 units.[1]

The second important step was to divide the total sales estimate among the various distributors in the United States and the export division. At a second conference, the executives had before them work sheets (with the final quota column blank) similar to that shown in Exhibit 1. These work sheets included the quota estimates and actual sales for each major product for 1934 and 1935, the quota for 1936 and sales for the first nine months of 1936, and for comparative purposes the sales for the first nine months of 1935. The next two columns gave the I.M.C. Buying Power Index as adjusted to conform with the sales territories of the Norge Corporation[2] and the conversion of this index to an aggregate figure. This latter step was accomplished by multiplying the total expected domestic sales by the percentage index for each territory. For example, the quota for Distributor M was set at 4.8% of 330,000

[1] The actual figure has been modified to protect the company.

[2] Inasmuch as the area included within each Norge distributorship did not coincide with state lines, the Norge Corporation modified the I.M.C. Buying Power Index by adding the indexes for each of the states and trading centers included within a Norge distributor's territory. The following table shows the method of compiling the index for the Norge distributor in Minneapolis, whose territory included all of Minnesota and North Dakota, as well as most of South Dakota and parts of Wisconsin and Montana.

State or Trading Area	Buying Power Index (Percentage of the United States)
Minnesota, Total of Combined Principal Trading Centers	1.5115
North Dakota, Total of Combined Principal Trading Centers	0.1830
South Dakota:	
Lead-Deadwood	0.0284
Rapid City	0.0348
Aberdeen	0.0840
Watertown	0.0553
Pierre	0.0257
Huron	0.0297
Mitchell	0.0464
Ashland	0.0329
Eau Claire	0.1076
	2.1393
Total for Minneapolis Distributor	2.1

EXHIBIT 1
NORGE CORPORATION
Work Sheet for Calculation of 1937 Refrigerator Quota for 10 Selected Distributors
(Unit: Number of refrigerators. All data modified by a constant percentage in order to protect Norge Corporation)

Distributor	Location	1934		1935		1936		1935
		Quota	Sales	Quota	Sales	Quota	Sales (nine months)	Sales (nine months)
M	Northeast	7,080	5,621	12,000	7,982	10,200	8,054	7,020
N	East	6,000	6,655	9,480	7,128	9,000	12,214	6,341
O	North Central	2,580	2,672	4,200	4,378	4,800	4,927	3,911
P	Southeast	2,640	2,496	3,840	2,719	3,840	3,667	2,683
Q	South	1,620	2,560	3,600	3,530	4,200	3,661	3,026
R	South	1,380	1,644	3,000	2,458	3,000	2,316	1,956
S	Middle West	4,890	10,207	9,000	6,068	9,000	6,025	5,312
T	Southwest	1,209	1,219	2,400	2,063	2,400	3,538	1,855
V	West	1,800	1,550	2,923	2,530	3,000	2,417	2,108
W	West	3,840	2,843	6,622	7,482	7,200	7,835	5,704
Total	....	33,030	37,467	57,065	46,338	56,640	54,654	39,916

Distributor	Location	1937 Estimates				
		Quota Estimate on Basis of Modified IMC Index*		Quota Estimate by Sales Statistician	Quota Estimate by Product Manager	Final Quota
		Percentage of Total in United States	Units			
M	Northeast	4.8%	15,840	12,000	10,200	12,000
N	East	3.6	11,880	15,000	14,400	13,200
O	North Central	1.9	6,270	6,000	5,760	6,000
P	Southeast	1.5	4,950	4,800	3,840	4,560
Q	South	1.7	5,610	4,800	4,800	4,800
R	South	1.2	3,960	3,600	3,600	4,200
S	Middle West	3.6	11,880	9,600	7,800	9,600
T	Southwest	1.2	3,960	4,200	3,600	3,600
V	West	1.2	3,960	3,600	3,120	3,600
W	West	2.9	9,570	9,000	9,600	9,600
Total, 10 Distributors	....	23.6%	77,880	72,600	66,720	71,160
Remaining Distributors	....	76.4	252,120	257,400	263,280	
Total United States	....	100.0	330,000	330,000	330,000	

* International Magazine Company Buying Power Index, adjusted to conform to Norge sales territories.

units. Quite independently the sales statistician and the product sales manager for refrigerators made estimates which were entered in the next two columns of the work sheet. These men used the same total for domestic sales but assigned different amounts to specific distributors. The final quota assigned to a distributor

EXHIBIT 2
NORGE CORPORATION
Number of Dealers in 10 Selected Distributorships, 1934, 1935, 1936

Distributor	Sept. 4, 1934	Nov. 30, 1935	Sept. 30, 1936
M	245	221	267
N	184	200	204
O	113	153	155
P	59	70	80
Q	87	93	126
R	156	85	126
S	227	246	261
T	42	69	80
V	54	61	72
W	99	141	169

Note: Distributors did not pursue a uniform policy with respect to granting exclusive representation to dealers. Some distributors also listed prospective dealers as regular dealers, in order to have them receive copies of all promotional literature.

was determined in the conference after considering the suggestions of the product sales manager and the sales statistician, the distributor's past sales, estimates of industry sales within the territory, and the amount of ales indicated by the application of the I.M.C. Buying Power Index. Among the materials examined were the data on number of dealers in Exhibit 2 and comparison of estimates against sales shown in Exhibit 3. Certain considerations other than statistical affected the determination of the unit quota for any one distributor on any specific product. In some territories, for instance, one competitor might have a strong foothold and outsell others two to one, or at an even greater rate. Such a competitor might sell 5,000 refrigerators in a territory in which the Norge Corporation sold only 1,500 but in which the expected Norge sales, according to the I.M.C. Buying Power Index, should have been 3,000. When the Norge executives believed that the distributor was doing as well as possible in light of the competitive situation, the distributor's quota would be fixed closer to 1,500 units than 3,000. The Norge executives also made allowance in their thinking and calculations for the experience of the distributor. A poorly organized distributor was likely to be assigned a smaller quota than his territory justified until such time as the Norge organization could strengthen his setup.

If the first approximations to the final quotas of distributors yielded a total sum greatly different from the original forecast

EXHIBIT 3
NORGE CORPORATION
Refrigerator Sales Performance versus Quota Estimates, 1934, 1935, and 1936

	1934	1935	1936
Total Number of Distributors on Quota	60	62	
Number Equaling or Exceeding Quota	33	17	
Number Exceeding Quota by 1%–10%	6	6	
Number Exceeding Quota by 11%–20%	6	7	
Number Exceeding Quota by 21%–30%	6	1	
Number Exceeding Quota by 31%–50%	5	1	
Number Exceeding Quota by More than 50%	10	2	
Number under Quota	27	45	
Number under Quota by 1%–10%	11	9	
Number under Quota by 11%–20%	7	12	
Number under Quota by 21%–30%	6	9	
Number under Quota by More than 30%	3	15	
Actual total sales as a percentage of quota	115%	96%	94%*
Increase in quota over preceding year	.....	25%	15%

* Nine months' actual sales as a percentage of 12 months' quota. Comparable figure for 1935 was 83.5 %.

of total volume, both that total and quotas for individual distributors were studied further until the two approaches to final estimates were harmonized.

The final quota shown in the last column of Exhibit 1 was presented to the distributor. This quota was regarded not only as a measure of factory expectations but also as a goal which the distributor should strive to reach. The executives of the Norge Corporation intended to set quotas which distributors had a reasonable chance to attain. Nevertheless, executives fixed another set of quotas (not shown in this case) on a more conservative basis. These latter quotas represented minimum sales estimates for the Norge Corporation's budgetary purposes.

Once determined, quotas generally were not considered open to further change. Nevertheless, it was recognized that from time to time there might arise, within the territory of any one distributor, conditions known to him but unknown to Norge executives which might make it desirable to change a quota figure. Such changes would, of course, almost inevitably be revisions downward. Occasionally distributors presented such evidence and were successful in securing revisions of assigned quotas. This practice was exceptional, not occurring more frequently than two or three times in each year.

Failure by a distributor to attain his quota was not regarded as an automatic signal for the discontinuance of his distributorship. Executives first attempted to ascertain the reason for the failure to reach expected sales. District managers and sales managers were assigned to study the difficulties encountered by the distributor and to consult with him in the hope of improving his position. Repeated failure to attain a quota, however, might be regarded as cause for discontinuing a distributorship.

Prior to 1937, Norge executives had believed that the conditions attendant on a rapid expansion of distributor organizations made it inadvisable to depend on a mechanical allotment of quotas based solely on the I.M.C. Buying Power Index. Marketing problems in specific areas were peculiar to the Norge organization, and it was believed that only a program of estimates could make satisfactory allowance for local conditions. The proposal to change to a mechanical base was supported by the argument that selling conditions in all territories by 1937 had been placed on a normal long-time base.

Should the Norge Corporation have made any change in its system of establishing distributors' quotas? Should it have modified the relations with distributors in any other respects?

Appendix

The International Magazine Company, Inc., stated that its Buying Power Index was so basic in character that it might be used as a foundation upon which to construct sales quotas for the average nationally distributed product.

The United States was divided into 626 consumer trading areas, and a Buying Power Index was assigned to each trading area, expressed as a percentage of the total United States buying power.

The 22 factors used in calculating the Buying Power Index by states were grouped under the following four heads:

People and Homes:

1. Population	Government Census (1930)
2. Urban Population	Government Census (1930)
3. Rural Population	Government Census (1930)
4. Total Families	Government Census (1930)
5. Native White Families	Government Census (1930)
6. Dwellings	Government Census (1930)
7. Home-owning Families	Government Census (1930)

Standards of Living:

8. Life Insurance Sales	Life Insurance Sales Research Bureau (1934)
9. Passenger Car Registrations	Polk Reports (1934)
10. Wired Homes	McGraw-Hill (1935)
11. Domestic Gas Consumers	American Gas Association (1931)
12. Telephone Homes	American Telephone and Telegraph Company (1930)
13. Radio Homes	Columbia Broadcasting System (1935)

Buying Power:

14. Income Tax Returns	Bureau of Internal Revenue (1932)
15. Net Income of Personal Returns	Bureau of Internal Revenue (1932)
16. Value of Manufactured Products	Bureau of the Census (1933)
17. Individual Bank Deposits	American Bankers Association (1934)
18. Amusement and Service Sales	Census of American Business (1933)
19. Wholesale Sales	Census of American Business (1933)
20. Retail Sales	Census of American Business (1933)

Distributive Outlets:

21. Wholesale Outlets	Census of American Business (1933)
22. Retail Outlets	Census of American Business (1933)

For each of the 22 factors, the total for each state was expressed as a percentage of the United States total. The percentages by states for each of the four groups were averaged, and another simple mathematical average was taken of the averages for each of the four groups by states. These formed the Buying Power Index by states.

In the computation of the trading area quotas, the following factors were used:

1. Total Families
2. Income Tax Returns
3. Passenger Car Registrations
4. Amusement and Service Sales
5. Wholesale Sales
6. Retail Sales

The Buying Power Index for each trading center was expressed as a percentage of the state total and of the United States total.

B. INDUSTRIAL GOODS

1. NATIONAL ROCK DRILL COMPANY

CHANNELS OF DISTRIBUTION

The National Rock Drill Company, a subsidiary of a large pneumatic-tool corporation located in Chicago, had been organized in 1907 to manufacture rock-drilling machines for use in metal ore mines. The subsidiary company at first had distributed its prod-

ucts on a small scale by means of one salesman, who traveled in mining districts to sell direct to mining companies. In 1922 the factory of the subsidiary company had been separated from that of the main company, and the subsidiary company thereafter had intensified its sales efforts by increasing its salesforce for direct selling. In 1924, by a few changes in design, the company adapted its mining tools for use in rock quarries and in such work as pavement breaking and demolition of concrete structures. Therefore the management had to consider what channels of distribution to use for its new line of construction tools.

The National Rock Drill Company had developed four types of mining tools, each particularly suited to a certain class of work in metal ore mines. The line of rock-drilling machines consisted of "drifters," weighing 125 pounds and selling for $365; "stopers," weighing from 75 to 100 pounds and selling for $185; "sinkers," weighing 41 pounds and selling for $175; and "augerjacks," selling for $170. These prices did not vary much from prices for competing machines of similar types.

The advantages over competing rock drills which the National Rock Drill Company claimed for its products were higher cutting speed; less vibration, and consequently less fatigue to the operators; greater ease of holding; and lightweight, yet durable, construction, which insured lower operating and repair expenses. These claims the company had substantiated under actual operating conditions by comparative tests with the principal competing drills.

From 1907 to 1922, sales of the National Rock Drill Company had been irregular with a small over-all increase. Sales in 1922 amounted to about $180,000. At that time the company had one salesman stationed in Denver to call on Colorado and Utah mines, and one salesman who on occasion was sent to any mining district in the United States.

At the time when the company had been organized, the management had chosen to sell direct to the mining companies because its five important competitors were well established and it believed that their competition could be met effectively only by means of personal salesmanship and demonstration, which mine supply firms or manufacturers' agents would not give. In 1922, when the company had secured a separate factory and had decided to develop the mines market more intensively than before, the manage-

ment had contemplated the use of supply firms or manufacturers' agents but had finally decided to continue direct sales.

There were several mine supply firms in each mining district. Some of these firms acted as exclusive agents for competitors of the National Rock Drill Company. Others were available as distributors of the company's products, either as exclusive agents carrying stocks or on a commission basis with the drilling machines shipped on consignment. The supply firms stocked a wide range of mine supplies, and frequently handled the products of several manufacturers of different types of mining machinery. The competitors of the National Rock Drill Company who distributed through mine supply firms employed missionary salesmen to visit mine superintendents and purchasing agents in order to interest them through personal salesmanship and demonstration. The supply firms stocked repair parts, new drill shanks, and bits for replacements.

Manufacturers' agents were available who would sell the National drilling machines on a 15% or 20% commission basis. Such agents did not carry stocks and ordinarily sold two or more noncompeting types of mining equipment and machinery. They usually, however, represented only manufacturers of heavy equipment or machinery which required installation service and technical advice. The companies they represented frequently were those whose potential sales in any one mining district were not large enough to warrant the maintenance of direct-selling organizations. When negotiations were under way for a large order or installation, the manufacturer commonly sent a field engineer to assist the agent in completing the sale.

Through the experience of its two salesmen, the National Rock Drill Company had learned that mine superintendents and engineers were the key factors in making sales of drilling machines. The superintendents and engineers specified the makes of machines which they desired to have used in the mines, and the purchasing agents for the mines bought the machines specified. To convince a mine superintendent of the merits of a machine, a salesman familiar with mining technique had to visit the mine superintendent underground and demonstrate the machine under actual working conditions. Mine purchasing agents, it had been learned, preferred to purchase such equipment as rock drills direct from the manufacturing company rather than through agents or supply firms.

Mining companies maintained their own repair shops and carried stocks of repair parts and replacement parts. They kept the tools in good working order and had a large reserve of tools above ground to send below without delay when breaks occurred. One mine, for example, had 150 drilling machines, of which 50 normally were working below ground at any one time and 100 were in reserve or in the repair shop.

When the company had decided to continue to sell direct to mining companies, it had begun to expand its salesforce, with the result that by 1924 it had 10 salesmen selling to about 300 mining companies. The salesmen chosen were men with mining experience, who, in many instances, were acquainted personally with mine executives in their territories. Each salesman had a territory determined by the location of the mining centers, the natural barriers, and trade customs. The salesmen established resident headquarters in their respective territories; usually each man had an office or shared part of a display room with a salesman of some noncompeting company. Each salesman received a salary of $250 a month, and the company paid his traveling and office expenses, amounting to an average of $300 a month. A salesman received a bonus of 2% of his salary if his sales in any accounting period exceeded five times his direct sales expenses, or a bonus of 3% if his sales amounted to more than six times his direct sales expenses. Sales had increased to $230,000 in 1923 and to $336,000 in 1924.

During 1924, the company tried out its new line of tools among Chicago road builders and construction contractors and learned that its tools could accomplish more work in a given period of time, with less air consumption, less repair and replacement cost, and less fatigue to operators, than could any competing tools. The prices of the company's rock-drilling machines for use in construction work were from $170 to $175. The prices of the paving breakers ranged from $175 to $195, and a hand-operated pneumatic spade for digging clay sold for $80 to $100.

The executives of the National Rock Drill Company had had no experience in selling to the types of customers who represented the potential market for its new line. Rock quarries constituted only a minor part of the potential market; they were not concentrated geographically or in large purchasing units as were the mines. The major market for the new line of tools was among construction contractors, particularly those engaged in road and

street construction and repair. Municipalities whose street departments did construction or repair work instead of letting it out to contractors were also potential purchasers. The market for the new line of tools, therefore, was national in extent, and the number of potential customers was large. The individual requirements of a majority of the contractors who were prospective purchasers of such tools as paving breakers were small, probably fewer than five breakers; and they ordinarily purchased one breaker at a time, whereas mines frequently ordered ten or more machines at a time.

By studying the technical and trade publications of the construction industries and by interviewing local contractors, dealers in contractors' supplies, and municipal officers, the company learned that contractors as a rule purchased their equipment and tools from supply firms and contractors'-equipment dealers. Frequently the dealers rented equipment to contractors. Contractors'-equipment dealers either purchased equipment for resale or accepted it on consignment from manufacturers for sale to contractors. These dealers sometimes acted as exclusive agents for equipment manufacturers. Often, however, they represented several competing or noncompeting manufacturers without any exclusive agency arrangements. A few of the equipment dealers also operated large construction companies. Since a dealer, in order to supply the complete equipment needs of contractors, usually represented several manufacturers, none of the manufacturers could expect the dealer to sell his particular lines aggressively.

Although the generally accepted method of distributing contractors' equipment was through the equipment dealers, a few companies manufacturing such equipment as steam shovels, concrete mixers, trucks, and air compressors maintained branch offices and employed salesmen to sell direct to contractors. The executives of the National Rock Drill Company, however, were of the opinion that the company's service problem might become serious if direct selling were attempted. Contractors, as a rule, did not keep on hand a supply of repair parts, as did mining companies. Because of the rough type of work for which such machines as the company manufactured were used and the necessarily delicate mechanism of the air control and application, the machines were frequently in need of repair. The company had observed that contractors took less care of their tools than mining companies did and that

the contractors' operators, taken from the ranks of unskilled labor, often continued to operate the machines after they were in need of repair. Although the machines were made so that the replacement of worn and broken parts was comparatively simple, the making of repairs was beyond the skill of the ordinary workman. Contractors relied, therefore, on the supply firms and equipment dealers for immediate service in supplying parts and in providing repair service.

Since other manufacturers had been selling such contracting tools as paving breakers for several years, the National Rock Drill Company was at a disadvantage in selecting dealers. Most of the leading equipment dealers already were representing competitors of the National Rock Drill Company. The company was at a further disadvantage in that it did not manufacture movable air compressors. Air compressors used in mines ordinarily were stationary, whereas for use in construction work air compressors were mounted on trucks to be taken from one job to another. Two of the company's leading competitors made movable air compressors and also pneumatic-tool equipment. The tools of the National Rock Drill Company could be attached by air hose to any make of compressor. The company, in 1924, in order to lessen the competitive disadvantage which it suffered through not making movable air compressors, completed selling arrangements with three companies which manufactured movable air compressors but did not make air tools. Those companies sold to all industries using compressed-air machinery. They sold to contractors through equipment dealers. According to the arrangements, the three companies agreed to sell National paving breakers as standard equipment with their air compressors when a contractor wished to purchase a complete outfit. They were to receive a small commission on the paving breakers which they sold as equipment for their compressors.

What plan of distribution should the National Rock Drill Company have used for its new line of tools?

2. WAVERLY MANUFACTURING COMPANY

USE OF MANUFACTURERS' AGENTS AND SUPPLY FIRMS

In 1924 the Waverly Manufacturing Company had begun to market a bench grinder[1] which it had developed some years previously for use in its own shops. For marketing this comparatively inexpensive machine the company had used chiefly the same distributors that it used for the high-price machines of installation type in which it specialized. In 1927, sales and production of the grinders were well balanced, but the company's plant facilities were capable of a substantial increase in production. The company concluded, therefore, that if it was to develop the market adequately and make full use of its plant, it would have to revise its marketing program.

The bench grinder was made in portable or stationary models of two sizes, known as the "Little Hustler" and the "Big Hustler," which sold for $125 and $250, respectively. The company's terms for the machines were 30 days net, f.o.b. New York, unless the weak credit standing of a purchaser necessitated advance payment. There were seven other companies in the United States manufacturing bench grinders which the company considered as competitors of the Hustlers. Prices of these competing machines ranged from $70 to $180. Accessory tools for use with the Hustlers also were sold by the company, either individually or in sets. A complete set priced at $125 included burrs, grinding wheels, flexible polishers, sanding drums, flexible wheels, cones, abrasive sticks, and wire brushes. Tools made for other bench grinders could be used on the Hustlers, but the tools especially designed for the Hustlers were superior.

Several special features made the Hustlers superior in certain respects to competing grinders. One of these features was the yoke on which were mounted the electric motor and the flexible shaft. The yoke was so arranged as to permit the motor and the shaft head to move up or down or to either side automatically as the operator changed the position of the tool he was using; this feature freed the operator from the necessity of readjusting the

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[1] A *bench grinder* is a machine consisting essentially of a small fractional horsepower electric motor driving a long flexible shaft to the end of which is attached the grinding tool.

machine when he changed the position of the cutting piece. The handpiece, which the operator held and into which the tools were fitted, moreover, was specially designed, and fitted with ball bearings so that it did not become heated. The shaft was belt driven by the motor, and the pulleys were so designed that four speeds were obtainable. A convenient belt-adjusting device permitted the operator quickly to change the shaft speed. A high-speed handpiece, not found on competing machines, was also provided. These special features were in part protected by patents.

The Hustlers could be used in practically all industries requiring grinding, drilling, or polishing of metals. They were especially useful in finishing castings which were too heavy to be brought to stationary grinders. The machines also could be used for polishing marble or porcelain and could be adapted for use in woodworking shops. The versatility of the machine was illustrated by the fact that a large fish-canning company used the grinder with an attachment for scaling fish.

When, in 1924, the Waverly Manufacturing Company had decided to market the Hustlers, it had induced the manufacturers' agents who sold its heavy installation machines to sell the grinding machines also. There were five of these agents in the United States, with offices so located that their territories were practically noncompeting. One agent had offices in Detroit, Pittsburgh, Chicago, and Cleveland; another had offices in St. Louis and Cincinnati; and the three others had offices in Birmingham, Boston, and Buffalo, respectively. Three of these distributors held exclusive agencies for the Waverly machines; the company did not grant exclusive territories to the Boston and Buffalo distributors, however, inasmuch as it sold many machines direct to manufacturers in New York and in the New England states. In addition to the Waverly machines, the agents sold heavy milling machinery, planing machinery, and die-cutting machinery of other manufacturers. The agents' sales were made chiefly to manufacturers of machinery, automobiles, railroad equipment, and electrical equipment. Since each sale involved a large sum, it usually was preceded by a relatively long period of negotiation between the agent's salesman and the executives of the purchasing firm. The Waverly installations, for example, sold for $12,000 to $30,000. All shipments of these machines were made direct from the company's factory to the customers. Production often was not started until orders were

received. The agents were paid a commission of 10% of the selling price for the large Waverly machines.

The company spent about $1,600 annually in 1924, 1925, and 1926 to advertise both the Hustler grinders and its heavy machinery in publications such as the *American Machine Tool Record*, the *American Machinist*, *Thomas' Register of American Manufacturers*, and *Iron Age*. This expenditure permitted only very small space in these publications, and the advertisements were little more than reminders of the company as a source of bench grinders and heavy machinery. In addition, the company exhibited the grinders at five different machinery shows held in connection with conventions of manufacturing executives and engineers of various industries. The company also provided its agents with advertising booklets concerning the grinders.

Manufacturers of competing bench grinders sold in various ways. Large companies producing many small machines that could be used in several industries generally had branch offices in the leading industrial centers. Their salesmen, operating from the branch offices, sold direct to users. Some small competitors sold through supply firms; others sold through manufacturers' agents who handled small machinery, such as air compressors, small pneumatic tools, and pipe-bending machinery. These agents had exclusive territories and sold usually on a commission basis to the users. Occasionally they sold also to supply firms.

A product sales manager with headquarters at the company's New York office devoted his time exclusively to Hustlers. He visited the five agents from time to time to assist them in selling the bench grinders. Exclusive agencies for the Hustlers had not been granted the five agents, and the company made some sales through mill supply firms and direct to users. Five men employed by the company to demonstrate its installation machinery also attempted to sell Hustlers. They received a commission of 15% of sales, as did the five agents for the heavy machines, to whom the company shipped Hustlers on consignment. Those agents were expected to purchase outright the stocks of accessory tools for the machines.

Users generally ordered only one or two Hustlers at a time, although large manufacturers sometimes purchased in greater quantities. Sales of Hustlers, including commissions, were $60,500 in 1924, $76,600 in 1925, and $112,000 in 1926. The gross margin

was approximately 56% of the selling price. In 1926 the company made 70% of its sales of Hustlers through the five distributors for its heavy machinery and 30% to supply firms or direct to users.

The mill supply firms through which Hustlers were sold occasionally stocked a large variety of articles for which there was a wide demand, such as general factory supplies, hardware, belting, standard fittings, small tools such as files and hammers, and small accessory machinery such as electric drills and small lathes. Some of these companies were territorial distributors for certain small machines, many of which were obtained from territorial representatives, who maintained stocks, after the mill supply house had received an order. Catalogues were published to facilitate mail orders, and salesmen were employed to call on mills, manufacturers, and machine shops. In some instances, a mill supply house specialized in supplies suitable for a specific industry; generally, however, these firms sold to any type of industry which had use for the merchandise which they stocked.

In 1927, the management of the Waverly company recognized that with its existing method of selling the grinders it was not developing the market adequately. The five agents for the large Waverly machines reached comparatively few of the potential customers for the grinders. None of them attempted systematically to cover the market for grinders. Small machine shops and many industries with numerous small units, such as furniture manufacturing and stone cutting, were not visited by the agents' salesmen, since their primary interest was in the installation machinery. The small amount which a salesman received for selling a Hustler, as compared with a heavy installation machine, also tended to lead to neglect of the grinders. The management knew of one instance in which a prospective customer who visited one of the agents for a demonstration of the Hustler was forced to wait two hours before the agent could locate a machine in the warehouse. Salesmen who were accustomed to selling high-price installation machinery, moreover, found the selling of inexpensive machines difficult. Whereas in selling the installations it was necessary to see the executives of the purchasing company, in selling the Hustlers the salesmen interviewed the foremen or superintendents. Some dissatisfaction on the part of the agents' salesmen also had arisen from the fact that, after they had introduced the Hustler to a prospective customer, that customer sometimes bought the machine

from the supply firm from which he customarily obtained his supplies and small accessory machinery. The five agents, moreover, had shown some unwillingness to purchase sufficient stocks of accessory tools for the Hustlers to provide prompt service in replacing worn-out tools. This service the management deemed essential to a successful marketing plan.

What method of distribution should the Waverly Manufacturing Company have adopted in marketing its bench grinding machines?

3. THORN COMPANY

MANUFACTURERS' AGENTS

The Thorn Company for over 35 years had manufactured a limited line of electrical equipment, consisting primarily of standard and special-order switchgear devices, priced from $6 for small manually operated units to $27,000 for large automatic apparatus used on high-tension lines. The average order for the large items amounted to $2,000 or $3,000, but the typical unit sale for all items fell slightly below $400. The annual sales of approximately $3,000,000 were made largely to public utilities and electric railway companies through manufacturers' agents and through the branch offices of the Handfield Company, which had absorbed the Thorn Company in 1931. The management of the Thorn Company from time to time had considered the use of company sales offices in preference to manufacturers' agents. In the spring of 1940, Mr. Hall, the sales manager, again raised this question; and in attempting to answer it he carefully reviewed the company's history in relation to the problem.

Since the Thorn Company at its inception had not been in a position to support sales branches, it had made use of manufacturers' agents, men with engineering training who were able to talk in technical terms about the products. By 1926, when the problem of discontinuing this method of distribution had first arisen, the company had achieved a nationwide market through 30 such agents, each covering an exclusive territory and selling, almost without exception, one or more allied but noncompeting lines. The annually renewed contracts between the company and its agents

provided for commissions on each class of equipment ranging from 5% to 10% and averaging about 7%. Out of these commissions, the agents paid all office, sales, and service expenses, other than the expense of keeping accounts receivable records, which the Thorn Company handled.

The Thorn Company advertised continually in trade papers which reached electrical engineers in central stations, electric railroads, and electric traction companies throughout the United States, and at frequent intervals circularized by direct mail a list of such engineers which it had compiled for its own use. It had also developed, for distribution to interested persons, a handbook of technical information especially useful to engineers. Although the company had built up an excellent reputation for its products and could point out many special features as selling arguments, the sales manager estimated that the factor of comparative prices could be assigned a weight of about 75% in influencing sales.

In considering the discontinuance of agents in 1926, the management realized that the company did not have so much control over these representatives as it could exercise over salesmen in its direct employ. The agents usually sold most aggressively the products which encountered the least sales resistance or which yielded the highest commissions. In a few instances the agents, after building up a volume sufficient to insure them an adequate income, seemed reluctant to fight for the additional business which the company believed existed in their territories. Although the company could exert pressure on these representatives by threatening to withdraw their agencies, it rarely took such a step because capable representatives were scarce.

In contrast to the Thorn Company, its two largest competitors, who manufactured complete lines of electrical supplies and apparatus, maintained direct-sales offices in practically all the large cities of the country. Smaller manufacturers competing with the Thorn Company ordinarily sold their products through manufacturers' agents.

In 1926 the officials of the Thorn Company who advocated the establishment of branches believed that the sales in each territory should determine whether a branch or an agent should be used. They estimated that the cost of operating a branch would amount to $20,000 annually, and cited eight instances in which agents' commissions had exceeded that figure in 1925. In fact, in two

territories the company paid commissions in excess of $40,000 a year. In the areas in which actual or potential sales did not warrant a branch, the officers proposed that the company continue to use manufacturers' agents.

In disagreement with the other company officials, the president did not favor the establishment of sales branches, for several reasons. First, he questioned the assumption that company salesmen would be more effective than manufacturers' agents in selling the Thorn line. He pointed out that the agents, by virtue of long residence in their respective territories, had established friendly relations with public utility executives, whom new salesmen would find difficult to reach. Furthermore, he argued, the use of manufacturers' agents was to the company's advantage in budgeting sales expenses, especially in periods of business depression, when the company paid lower commissions in proportion to lower volume and the representatives bore the fixed expenses of maintaining offices and sales organizations. Finally, it was his opinion that the company had a moral obligation to those agents who had been loyal to the organization for many years, even to the extent of incurring losses on the sale of its products, especially during the initial promotional period. A policy of establishing a sales branch in a territory as soon as it yielded a profitable sales volume would be evidence of ingratitude to the agents displaced and would antagonize those that remained. Since the president's views prevailed in 1926, the use of manufacturers' agents was continued.

In 1931 the Thorn Company was purchased by the Handfield Company, a large manufacturer of crushers, sawmill equipment, mining machinery, steam turbines, motors, generators, transformers, and many other types of electrical equipment. The Handfield Company had seven factories in the East and Middle West and 50 district sales offices, which ranged in size from those with only one salesman and a stenographer to those in Chicago, Philadelphia, Pittsburgh, and New York with over 30 salesmen each. In the larger offices several of the salesmen were specialists on certain items or certain industries; a salesman in New York, for instance, sold only steam turbines; and another in Pittsburgh concentrated on customers in the steel industry. The regular branch salesmen, however, were assigned a section of territory and were expected to solicit all potential users of any of the company's products in that territory. These men had a tendency to

specialize on the type of equipment most commonly used by their customers, but they were sufficiently familiar with the other equipment to open negotiations. When a regular salesman discovered a potential customer for a complex installation, he acquired enough information to furnish a sales engineer in the home office with data to make the initial cost estimates. If the prospective buyer seemed responsive after the salesman had discussed these calculations with him, the sales engineer came from the home office, called on the customer with the salesman, made detailed estimates, and submitted a bid.

The sales engineers were each attached to one of the 20 product divisions of the Handfield Company. Their function was to furnish all possible technical information on their respective products and to act as technical assistants to the salesmen. They were not expected to take over the negotiations initiated by the regular salesman. Since the position required a great deal of tact, the men employed were of high caliber. Their importance in the sales efforts of the company was indicated by the fact that the number of sales engineers at the factory almost equaled the number of men on the road.

The head of each product division of the Handfield Company was responsible for both the manufacture and the distribution of the division's products. Although only the Thorn Company and one other division used channels other than the district offices, every division was at liberty to make such arrangements. The Handfield Company made a quarterly allocation of district office expense on the basis of the dollar sales of the products of each division. If the Thorn division wished to employ a manufacturers' agent in any territory, it was required to pay half the selling expense normally allocated to that territory in addition to the full amount of the agent's commission. Since each manager was held responsible for showing profitable operations in his division, he considered efficient distribution important.

Soon after the merger, the manager of the Thorn Company recognized that the use of district sales branches offered a decided advantage in certain territories, as, for instance, in the one covered from Phoenix, Arizona. For several years the agent there had experienced difficulty in making a living and had been unable to devote sufficient time and money to soliciting new business. After the change, sales increased almost immediately, because the

Handfield salesmen were already in contact with the chief users of electrical control equipment in this section—the large mining companies—and found no difficulty in including a mine's requirements for this equipment in an order for the most expensive mining machinery.

As a result of similar situations, in the period between 1931 and 1940 the Thorn Company severed relations with more than half its agents, so that in 1940 only eight remained. In general, these were the oldest and best-established of the group with which the company originally had done business. Their sales consisted primarily of large orders from relatively few companies; in fact, some of them obtained only 30 or 40 orders a year but sold over $100,000 worth of equipment. Their intense loyalty to the Thorn Company resulted from the fair treatment it had extended to them. The company, for instance, had always paid commissions on the day that goods were shipped from the factory and had made it a policy never to ask an agent to cut his commission, even when a lower price seemed necessary.

The rate of commission, which had remained approximately the same for over 20 years at an average of about 7%, was considered to represent compensation for three distinct functions: (1) for the initial effort of interesting the proper purchasing authority; (2) for any additional contact work necessary to clinch the deal; and (3) for the general task of covering and servicing the territory in which the equipment was to be used. Thus it was entirely possible that three people might share in the commission on one order. For example, an agent in Chicago, in negotiating a sale to a utility in his area, might have found contact work necessary with the officers of the parent utility company in New York and might have enlisted the assistance of another agent or a salesman from the district office there. If, conceivably, the utility had purchased the equipment for its property in Minneapolis, the agent who covered that territory would be responsible for any installation or service work. In this case, each agent would receive one-third of the commission. In the more usual situation, however, an order originated and was completed in the same territory in which the goods were delivered; hence a single agent received the full commission.

The circumstances which had precipitated the discontinuance of all but eight agents were varied, and the results of the change lacked uniformity. In one situation, the management believed

that the district sales offices of the Handfield Company could cover the states of Nebraska and Oklahoma more effectively than could the agent in Kansas City. But this agent, a competent salesman, refused to relinquish his territory; and when pressed in the matter, he canceled his franchise. After the district offices in Kansas City, Tulsa, and Omaha had undertaken the sale of the Thorn electrical control equipment, the immediate result was a falling off in volume in the Kansas-Missouri area; but increased sales in Oklahoma and Nebraska almost compensated for the decline.

In Philadelphia, on the other hand, the company insisted that the agent discontinue his contract, inasmuch as he had neglected the Thorn line for other, more remunerative business. He had originally sold transformers for another division of the Handfield Company and had acquired the Thorn line in 1931 as a result of the unaggressive methods of his predecessor. This new agent had appeared to be in an excellent position to do an effective selling job on both lines, since he had four salesmen for this purpose and, as owner of an electrical supply jobbing business, employed 20 men who could occasionally report prospective customers for transformers and electrical control equipment. Many of the particularly large users of electrical equipment in the Philadelphia area were customers of the Thorn Company and of other divisions of the Handfield Company. The usual practice among companies of their size was to divide an order among three or four large electrical companies, each of which would supply certain types of equipment. In such a situation, the Philadelphia agent had invariably attempted to persuade the customer to specify transformers, which yielded an average commission of 10%, in preference to the Thorn Company's equipment, which paid only 7%. Since a large proportion of the business in the Philadelphia area arose from such sources, the Thorn division found its volume falling off; and finally, in 1935, it canceled the agent's contract.

Faced with the problem of how to distribute its product in the Philadelphia area, the Thorn division decided in favor of the policy of utilizing the divisional sales offices wherever possible, in order not to confuse its customers by having more than one outlet. It was the opinion of Mr. Hall, however, that the Thorn line would not receive a great deal of promotional effort at the hands of a general salesman from the Philadelphia office. Consequently he had engaged at the divisional office a special salesman, an

employee of the former agent who had been chiefly responsible for most of that agent's sales of Thorn equipment. For the years 1931–1935, sales had ranged from $80,000 to $225,000 a year; but during the subsequent four years, under the new arrangement, they rose to an annual average of $200,000. Although Mr. Hall took into account the widely differing business conditions during the two periods, he believed that the new salesman had achieved steadier sales by his closer day-to-day attention to all possible outlets.

In some cases in which the Thorn Company had continued to distribute through manufacturers' representatives, it had found a compromise arrangement desirable. For instance, the company had an excellent agent in Chicago, the greater part of whose sales came from several very large customers. Although the agent had the right to cover an area including most of Illinois, northern Indiana, and part of Iowa, Mr. Hall believed that the district office salesmen could do a more effective job in most of that territory. By an agreement with the agent, the company assigned to him certain customers with whom he was on very cordial terms, and instructed the district office to cover the rest of the territory.

Further details concerning the eight representatives who continued to handle the Thorn products in 1940 are given in the following paragraphs.

Akron and Cleveland, Ohio. The Akron agent had represented the company for 26 years in northeastern Ohio and in two counties in Pennsylvania. His business, which was distributed among a large number of customers, had amounted to as much as $300,000 annually up to 1937 and subsequently averaged $150,000 a year. Three other men, one of whom managed the Cleveland office, assisted him in the sale of Thorn electrical control equipment and two less important lines of equipment.

The Handfield Company maintained a large district office in Cleveland and had a resident salesman in Akron, who called exclusively on customers in the rubber business.

Baltimore, Maryland. The agent in Baltimore, where the Handfield Company also maintained a district office, solicited sales in Maryland, the District of Columbia (exclusive of government business), and four adjacent Virginia counties. When he had originally become associated with the Thorn Company 18 years earlier, southern Delaware and the entire state of Virginia had also formed part of his territory. Assisted solely by his son, he had

achieved sales of $100,000 a year. The Thorn line was by far the most important of the four related but noncompetitive lines which he handled.

Charlotte, North Carolina. The representative here had handled the Thorn line for 12 years with the assistance of a salesman previously employed at the factory. This agent also represented the transformer division of the Handfield Company and, in fact, sold more transformers than he did Thorn equipment. One large customer, with whom he had a personal understanding, accounted almost entirely for his annual sales of $100,000.

Chicago, Illinois. The Chicago agent had attained sales as high as $1,000,000 annually during the 20 years in which he had been associated with the Thorn Company. His current sales of $300,000 originated from six large customers, specifically assigned to him.

Detroit, Michigan. The representative in Detroit had sold the Thorn line for 25 years, originally as salesman for the owner of the agency, whom he succeeded after 17 years. He currently employed two other salesmen. His sales of Thorn equipment averaged $100,000 annually, although they had once been as high as $500,000 a year. He sold three other related but noncompetitive lines, with a total volume twice that of the Thorn line. In his territory, which consisted of the whole of Michigan, there were three Handfield district offices.

Jacksonville, Florida. The agent here had handled the company line for only six years, but had formerly represented the transformer division of the Handfield Company. One customer supplied practically all his business, which amounted to only $50,000 a year.

Rochester, New York. As representative of the Thorn Company for seven years, this agent had covered a small territory around Rochester; he sold approximately $50,000 in electrical control equipment annually. Two other lines accounted for a small proportion of his business.

St. Louis, Missouri. The agent in St. Louis had handled the Thorn line for 28 years; and although he had two minor lines, he secured most of his volume from sales of Thorn equipment. With no assistance he covered a relatively large number of customers in a small territory. His sales had run as high as $300,000 a year, and in 1940 were averaging $100,000. The Handfield Company had two district offices within his territory.

Mr. Hall recognized that there would be definite advantages in concentrating the distribution of the Thorn product in the Handfield district sales offices. In the first place, experience in Philadelphia and elsewhere had indicated that, in the long run, selling the product through the district offices was somewhat cheaper than through manufacturers' agents, although the method of allocating expenses resulted in highly irregular selling costs, which made short-run comparisons difficult. He cited instances in which the costs for three months had been as high as 20% and as low as 1½% of the division's sales. Second, he pointed out that it was an advantage to the customer to purchase all his needs for Handfield equipment through the same outlet. Finally, it was his opinion that the concentration of sales operations in a few offices would minimize internal friction in the Handfield Company and would allow the company greater freedom in the promotion of its products.

Even in 1940, however, arguments for continuing the distribution of electrical control equipment through independent agents remained important. Most significant was the closer personal contact which the agents seemed to be able to maintain with prospective customers. Unlimited by the restrictions of office routine, independent agents could entertain customers as they pleased and do whatever in their judgment was best calculated to obtain business. Long residence in their territories gave the agents added familiarity with their customers, which company salesmen, frequently transferred by promotion, did not share. Furthermore, the remaining agents were exceptionally capable men, whom the company would have great difficulty in replacing. The agents offered the Thorn division a means of direct control over the sale of its product, since they were responsible only to the manager of the division; the salesmen in the district offices, however, were responsible to their respective branch managers, who, in turn, reported to a number of product managers within the Handfield Company. Finally, since the agents sold between 30% and 40% of the annual volume of the division, their sudden discontinuance might be dangerous, especially in view of the possibility of their taking on a competitive line of electrical control equipment.

What action, if any, should the Thorn Company have taken with regard to the eight manufacturers' agents who still represented it?

4. CARLINK CHAIN COMPANY

PROPOSAL TO ESTABLISH SALES BRANCHES

After a study of several months, the sales manager of the Carlink Chain Company proposed to the president that sales branches should be substituted for distribution through mill supply firms.

The Carlink Chain Company manufactured high-grade machined steel roller chains in approximately 100 designs for use by 125 industries either for the transmission of power in plant operations or for incorporation into machines manufactured. The sales of the Carlink Chain Company, which were about $1,000,000 annually, fell into two classes: (1) chains for power transmission on mine locomotives, canning machines, coal stokers, textile machines, machine tools, and a wide variety of factory equipment; and (2) chains for use as drives on automobile trucks, cement mixers, road machines, agricultural machines, and other implements. The company estimated that 75% of its sales were in the first class and 25% in the second.

A summary analysis of the sales of the Carlink Chain Company was as follows:

SALES CLASSIFIED BY USE

Chains for Power Transmission:		
Standard Items	$ 700,000	70%
Manufactured on Special Orders	50,000	5
Chains for Use in Finished Equipment:		
Sales to Manufacturers of Automobiles and Equipment	200,000	20
Estimated Replacement Sales	50,000	5
Total Sales	$1,000,000	100%

SALES CLASSIFIED BY METHOD OF DISTRIBUTION

Direct Sales:		
To Manufacturers of Automobiles and Equipment	$ 200,000	20%
To Buyers of Special Orders	50,000	5
To Large Buyers of Standard Items for Power Transmission	150,000	15
	$ 400,000	40%
Sales through Middlemen:		
Estimated Minimum Sales through 28 Supply Firms	$ 550,000	55%
Estimated Maximum Sales through Other Middlemen	50,000	5
Total Sales	$1,000,000	100%

Since automobile and implement manufacturers who incorporated Carlink chains in their products purchased direct from the company, exact records were available which showed that 20% of total sales consisted of original installations. Replacement purchases made by users of trucks and implements were handled by the truck or implement manufacturer, by the Carlink Chain Company itself, or by automotive equipment wholesalers. Because of this variety of channels the company was not positive of the accuracy of its estimate that 5% of total sales represented replacements for trucks and implements, but in any event the sales manager was convinced that the company was not securing its proper share of this kind of business. Truck manufacturers buying Carlink chains as fabricating parts customarily ordered in advance of their needs, placing contracts covering their requirements, but implement manufacturers ordinarily did not.

Chains for use in plant equipment consisted of the standard line, which was kept in stock at the factory, and of special orders. Special orders, which amounted to 5% of sales, were always handled direct by the company. In many instances, the company suggested slight changes in the designs submitted by a customer, in order to reduce the cost of manufacturing the special type of chain ordered. These recommendations frequently were made by correspondence. Though constituting but a small part of the total sales volume, special orders were profitable and appeared to be increasing in number. The four major competitors of the Carlink Chain Company were making no calculated effort to appeal to the special-order market. The experience of the company had been that, on the average, one type of chain out of each 100 manufactured on special orders was worth adding to the standard line.

Industrial customers who purchased chains for use in power transmission to machines in their plants ordered when new machinery was installed or when existing drives wore out. Business with this class of customers on standard items represented 70% of total sales. For some years there had been standardization of types of chains, with the result that the industrial buyer could choose the product of a different manufacturer after the original installation had been made. This choice was further facilitated by the fact that sprockets often were purchased at the same time as replacement chains. It was the judgment of the officers that commonly two sprockets were worn out before a replacement chain was needed.

Reputation for quality of product and promptness of delivery service were important factors influencing the purchase of chains by replacement buyers. Many of the orders from industrial users ranged in amount from \$25 to \$50. The company seldom received orders from an individual industrial user more than twice a year. Frequently these customers required engineering advice. The Carlink Chain Company endeavored to provide this service through five engineer salesmen, whom it sent to customers' plants when it received requests for advice either direct or through mill supply firms; the company employed no other salesmen. When there was not enough technical advisory work to keep the five salesmen occupied, they made visits, for purposes of sales promotion, to mill supply firms, automobile and implement manufacturers, and industrial customers who purchased direct from the factory; but no orders were solicited on these visits.

Prior to the proposal of the sales manager, the company had sold its chains direct to large buyers, through 28 mill supply firms, and through a large number of automotive, farm implement, and hardware wholesalers. Direct sales made up 40% of the total sales volume; of this amount, 20% represented purchases by truck and implement manufacturers, 5% special orders, and 15% purchases by large industrial plants for use on equipment. All these transactions were negotiated by the officers of the company, including the sales manager, with the assistance of the five engineer-salesmen.

The sales manager also undertook personally the responsibility for maintaining relations with the 28 mill supply firms which carried stocks of the company's chains. Four of these firms, which had average annual sales of Carlink chains of \$30,000 each, had been given exclusive agencies. These four firms received commissions on all sales of Carlink chains in their respective districts, except those to truck and implement manufacturers. This policy, which cost the Carlink Chain Company between \$6,000 and \$8,000 a year, was deemed desirable in order to maintain the goodwill of these large mill supply firms. In the districts of the remaining 24 mill supply firms, the Carlink Chain Company retained the right to sell to any buyer. The company gave higher discounts from its list prices to these 24 firms than to others, thus permitting them to quote lower prices. In practice, therefore, sales were restricted very largely to the favored distributors. The Carlink Chain

Company paid no commissions on direct sales in these territories, however.

Average inventories of Carlink chains carried by mill supply firms ranged from $5,000 to $15,000. All these concerns had stocks of supplies other than chains for sale to the industries in their districts. The Carlink Chain Company suggested that mill supply companies take a 20% markup on Carlink chains. The management believed this to be lower than their markup average on other items. There was no assurance of uniform price quotations in each district. It was unlikely, however, that selling prices would be higher than those suggested by the company.

Less than 5% of sales were made to automotive, farm implement, and hardware wholesalers, who, in turn, sold to truck owners, garages, and repair men. The sales manager occasionally solicited the business of these wholesalers, but most of the orders were placed by mail. The chains were designed to last for the useful life of the truck or implement.

The plan proposed by the sales manager called for the immediate establishment of 5 branches in the more important districts and for a gradual increase of that number to 15. The sales manager believed that the company would need 15 branches eventually if it were to secure the benefits from aggressive selling. The branches were to sell all types of Carlink chains.

The average inventory necessary for each branch was estimated at $20,000. The Carlink Chain Company always had maintained from 60 to 90 days' stock at the factory for the benefit of the distributors; and even with a branch organization, a factory stock department would have to be maintained. It was not feasible to ship parts to a branch and assemble chains there as ordered, because of the highly skilled labor necessary for assembling; a man skilled in assembling one design commonly was not adept in assembling another. It was likely, however, that the stock carried at the factory could be reduced after the branch organization was firmly established. The manufacturing period varied, according to the size of chain, from five days to two weeks.

Average estimated sales per branch were $40,000 for the first year. The annual minimum fixed expense for the proper administration and operation of each branch was estimated at $12,000; this figure included the salary of an engineer-salesman. The company expected that sales could increase 50% per branch

without affecting expenses appreciably. Each suggested branch territory included from 500 to 1,000 industrial users of chains and approximately 500 dealers in automotive equipment. About one-fourth of those firms already used or sold Carlink chains. The sales manager proposed that the control of credits and collections be decentralized in the branches.

The sales manager was of the opinion that increased sales volume must come principally from small industrial users and from manufacturers who incorporated Carlink chains in their products. Availability of stocks of standard chains for immediate service in case of breakdowns was an influential selling point in obtaining orders from small industrial companies which could not afford to maintain supplies of chains as insurance against loss of time. Large industrial users commonly maintained reserve stocks of chains at their plants.

One competitor of the Carlink Chain Company operated 6 branches with complete stocks and 16 branches without stocks. This competitor also was represented by supply firms in territories not served by the branches. In the districts where this competitor operated branches with stocks, sales of Carlink chains had not increased so rapidly as in other districts. Observation of developments in other industries indicated that the establishment of sales branches frequently became general when one manufacturer took the lead.

Should the sales manager's plan for establishing sales branches have been approved?

5. STANHOPE COMPANY

PROPOSAL TO ESTABLISH BRANCHES

In the spring of 1938, officers of the Stanhope Company were considering changes in the company's distribution system. The Stanhope Company manufactured several lines of related electrical equipment for installation as private telephone systems, apartment house doorbells, buzzer systems, and lobby, suite, and janitor-answering telephones and annunciator boards. These products were sold to electrical supply wholesalers throughout the United States by 25 manufacturers' agents. The final buyers of the items

were classified into three groups: (1) residential, including owners of private residences and apartment houses; (2) institutional, such as schools and hospitals; and (3) industrial, comprising office buildings, stores, warehouses, and factories. Each of the three markets accounted for approximately one-third of the company's total sales.

All the officers were well satisfied with the status of the company's business in the first two of these markets, and all were dissatisfied with the volume of business being secured in the industrial market; disagreement had arisen, however, as to what, if anything, should be done about that market.

In the 1890's the Stanhope Company had been engaged principally in selling telephone systems in competition with Bell equipment. At that time there were many independent exchanges, and these constituted the chief market of the company. Mr. Stanhope, the company's founder, bought parts from several sources, made the sales, and arranged for the installation of the equipment. When the various operating units of the Bell telephone companies began to purchase the independent exchanges, Mr. Stanhope realized that his market would disappear; and he decided therefore to concentrate his efforts in the industrial field. He soon learned that there was a demand for the installation of telephone and signaling systems in industrial plants and for service on these systems once installed. Consequently, the company established an installation and service department.

In 1912 the company had begun to produce telephone systems for apartment houses, many of which were installed by company crews. By 1923 the peak of home and factory wiring in new construction had passed, and more electrical contractors became interested in doing the installation work in connection with the sale of Stanhope equipment. As a result of the pressure from contractors, the company gradually gave up its own installation and service crews. In the early 1920's the contractors who handled installation and service were large firms whose credit ratings were generally good and easily obtainable. During the late 1920's, however, many small contractors entered the electrical trade. Some of these firms were poor credit risks or were financed largely by electrical wholesalers. The company did not wish to sell direct to such contractors, and therefore began to sell to wholesalers who supplied these contractors.

For a time the company sold direct to large contractors and to wholesalers; but after careful consideration, the management decided to adopt a policy of selling exclusively to wholesalers. Thereafter the company's sales increased substantially. Stanhope products were listed in the catalogues of wholesalers, and many firms preferred to sell Stanhope items. In the opinion of one officer, this distribution policy had been such a success that it should not be altered. Other officials, however, believed that the company's distribution policy had been unfavorable to the satisfactory development of the industrial market.

The Stanhope Company quoted list prices on equipment (uninstalled) which often were identical with those quoted by competitors. The company usually suggested that final purchasers be allowed 25% off list by contractors, and contractors 40% off list by wholesalers; the company gave wholesalers 40% and 10% off list, discounts which, in effect, gave the wholesalers a gross margin of 10% of the suggested price to contractors.

Most of the 25 manufacturers' agents who represented the company also sold allied but noncompetitive products of other firms. The compensation of the agents depended entirely on commissions, ranging from 5% to 15% of the company's selling price. The agents received commissions on all shipments into their territories. The nature of allied products, the salesmen's commissions on Stanhope items, and an estimate (by an executive of the Stanhope Company) of the percentage of these commissions to total earnings for a group of representative agents in 1937 were as shown in Exhibit 1. Each of these six agents sold to electrical wholesalers, and also did missionary selling to final buyers. Agent A, for example, specialized in selling to school systems.

The chief task of agents was to develop acceptance of Stanhope products. They were furnished by the sales manager with information concerning new construction on the basis of the F. W. Dodge reports. Inquiries received at the home office were also forwarded to them. Frequently the agents worked with architects and helped them to write specifications for the use of Stanhope equipment. Company officials were well satisfied with the company's share of the business obtained in the residential and institutional markets, most of which originated in connection with new construction. They were only moderately satisfied, however, with the business obtained in connection with newly erected industrial plants. They

believed, furthermore, that existing industrial plants offered a market for the company's products that had not been reached satisfactorily. For this portion of the potential market there was no readily available source of information regarding prospective customers.

Although the basic parts of the equipment produced by the Stanhope Company were standardized and subject to list prices,

EXHIBIT 1
STANHOPE COMPANY
Gross Earnings of Representative Agents in 1937

Agent	Other Lines Carried	Commissions on Stanhope Items	Estimated Percentage of Stanhope Commissions to Total Gross Earnings of Agent
A	Scientific Instruments, Resisters, Rectifiers, Condensers, and Radios	$1,643	5%
B	Conduit, Friction Tape, Emergency Lighting Equipment, and BX Cable	5,060	40
C	Cable for Residences, Apartment Houses, and Schools; and Electric Doorbells	8,330	75
D	None	9,155	100
E	Hospital Signaling Equipment, Airplane Instruments, Connectors, and Relays	3,752	60
F	Laboratory Panels, Clocks for Schools, and Hospital Signaling Equipment	1,174	Not known

almost every installation had to be planned and adapted to the circumstances.

In the residential market, home and apartment house owners engaged electrical contractors to install telephone systems and signaling apparatus, such as doorbells. In most instances estimates were submitted by several contractors. Contractors, in turn, purchased through wholesalers. Regardless of whether the wholesaler had the equipment in stock, as in the case of doorbells and transformers, or had it shipped direct from the factory, as in the case of telephone systems, he had to finance the sale because the credit rating of such electrical contractors was not satisfactory

to the Stanhope Company. Contractors added their installation and overhead costs to the equipment costs to arrive at bid prices.

The company's procedure in selling to the institutional market varied slightly according to the size of the installation. On small installations, buyers advertised for bids from electrical contractors. The latter submitted their bids on the basis of the best prices which they were able to obtain on equipment from the Stanhope Company or from other suppliers. Usually the manufacturers' agent representing the Stanhope Company tried to induce an electrical contractor to bid for the business on the basis of using Stanhope equipment. If this contractor was the successful bidder, he placed the order for the equipment with an electrical wholesaler. The latter assumed the credit risk and financed the contractor, for which service the Stanhope Company allowed him a markup of 10%.

Large institutional sales, however, involved considerable planning and designing, which was done by the company's engineers or manufacturers' agents. This extra engineering cost had not been taken into account in establishing the list prices and discounts on equipment items. Furthermore, the company had to meet price competition on these large orders, and consequently it could not allow a margin to the wholesaler and have any possibility of profit for itself. In order to maintain good relations with its wholesalers, the company, in advance of bidding, explained to them why it could not allow them the customary margin. Under such circumstances, the company made direct sales through its manufacturers' agents to the contractors who bid on large institutional orders. The credit ratings of these contractors generally were satisfactory.

All the Stanhope Company's executives believed that the potential sales of its lines in the industrial market were far larger than the volume of business actually being secured. This opinion was based on an intimate knowledge of the industrial market in the region near the company's factory, on casual impressions of conditions in the remainder of the country, and on the fact that 3 of the manufacturers' agents representing the company made a substantial volume of sales to industrial concerns, whereas the other 22, many of whom were located in as highly industrialized territories, made very few sales in this field. The usefulness of Stanhope equipment was not limited to any particular industries. Physical size, layout, the nature of the business, and communication

needs determined the desirability of installing signaling and communication systems.

The company made sales to industrial users through the joint efforts of manufacturers' agents and wholesalers. The installation of equipment for industrial customers usually required engineering advice and supervision. The company relied more on wholesalers' salesmen than on the manufacturers' agents to find prospective buyers in the industrial market. Certain company officers were convinced that more satisfactory results might be achieved if manufacturers' agents were used more extensively, with engineering assistance from the Stanhope Company when necessary.

All the executives were agreed on the following reasons for the ineffectiveness of the company's distribution system: (1) Although wholesalers' salesmen called regularly on industrial customers, they did not have time to devote to selling this specialty line in conjunction with taking orders for the numerous small items which the electrical wholesalers handled; (2) they did not have the technical training necessary for selling these products; and (3) they did not follow up inquiries from the direct-mail campaigns of the company. For instance, inquiries resulting from direct-mail advertising were frequently as high as 12% of the mailings, but wholesalers took no substantial action on more than 1% of these prospects.

Company officials, furthermore, were dissatisfied with the profit margin obtained on industrial sales, partly because selling expenses were believed to be unduly high. In addition to the customary 10% margin for wholesalers, the company had the expense of sending its engineers to customer plants to design installations of equipment and to negotiate sales. When the prospective buyer was located at a considerable distance from the company's plant, however, the company informed the manufacturers' agent in that locality about the possible customer and paid him a standard commission to make the sale and furnish engineering advice. The agent, however, might not follow up the lead if he thought that the commission would not be sufficiently large to cover his time and expense.

Besides the foregoing difficulties, trade practice forced the company to use electrical contractors for the installation of all equipment sold to the industrial market. The sales procedure was for the wholesaler's salesman, the manufacturers' agent, or the company's engineer to convince the user that he needed

Stanhope equipment; one of them then asked a contractor to quote an installed price. The contractor who billed the user bought the equipment from the wholesaler, who, in turn, purchased from the company. Many industrial customers, however, wanted to buy the equipment and install it themselves. They had general utility or maintenance men who were capable of installing the equipment with the aid of blueprints provided by the company. In addition, since the equipment used low voltage, it was not subject to inspection under the building codes and therefore did not have to be installed by licensed electricians. Nevertheless, if electrical contractors were not employed and given their customary discount on equipment, a national trade association of master electricians would threaten to place the company on its black list; that is, members of this trade association would attempt to prevent the use of Stanhope equipment. Such a risk the company could not afford to incur, because electrical contractors were necessary in selling to other markets.

One executive believed that the way to increase sales and profit margins in the industrial market was to establish a company salesforce specializing in selling to business and industrial concerns and thus eliminate the wholesalers and the manufacturers' agents completely from such sales. Each field salesman would require an office, and the executive estimated the annual expenses of each such sales unit as follows:

Salesman's Salary	$5,000
Traveling	1,500
Advertising	500
Office Expense	1,000
Credit, Collection, and Miscellaneous	500
Total	$8,500

The company had ample financial resources to establish the sales offices if it decided to do so.

This officer thought that his proposal of direct sale was feasible in only four or five of the existing agents' territories. In order to illustrate the value of his suggestion he had analyzed two of these territories. Total sales (at list prices less 40% and 10%) in 1937 of Agent C (see Exhibit 1) were $67,000, of which $7,200 were sales to industrial customers. Commissions paid by the Stanhope Company to Agent C were $8,330, of which $720 represented

commissions on sales to industrial buyers. Since the manufacturing cost on industrial sales amounted to 80% of sales, the margin for selling and administrative expenses and profits realized on Agent C's industrial sales was $1,440, of which $720 was paid to him as commissions. Under the proposed plan the company would eliminate the wholesaler and Agent C, and would sell at the prices previously charged by wholesalers, that is, list prices less 40%. These prices would not include installation charges. The industrial buyer would assume the responsibility for installation, either by using his own maintenance crew or by employing an electrical contractor. Consequently, in estimating the sales of a proposed direct-selling office the executive increased the 1937 sales figure by the amount of the margin previously allowed the wholesalers. Thus in this territory the same physical volume of sales would amount to $8,000 instead of $7,200.

The second territory analyzed was that of Agent B, whose sales of Stanhope products in 1937 amounted to $45,000, of which $18,000 comprised sales to industrial users. The total commissions paid to Agent B were $5,060, of which $1,800 represented commissions on industrial sales.

The officer's estimates of potential sales, expenses of company sales offices, and margins in these two territories were as shown in Exhibit 2.

Other executives were not convinced that a shift from manufacturers' agents was indicated. Among the possibilities suggested

EXHIBIT 2
STANHOPE COMPANY
Estimates of Potential Sales, Expenses, and Margins for Two Selected Territories

	Territory of Agent B	Territory of Agent C
1937 Industrial Sales at Higher Billing Prices	$20,000	$ 8,000
Estimated Additional Industrial Sales	10,000	42,000
Estimated Total Sales	$30,000	$50,000
Estimated Manufacturing Cost on Industrial Sales (72% of total sales, at higher prices)	21,600	36,000
Difference	$ 8,400	$14,000
Estimated Total Expenses of Branch Office	8,500	8,500
Margin for Central Office Expenses and Profits	$ 100*	$ 5,500

* Deficiency.

by these men were: (1) the use of additional manufacturers' agents whose other lines definitely brought them into contact with industrial firms, (2) the replacement of existing manufacturers' agents by others better equipped to secure business from industrial concerns, and (3) the encouragement of the existing agents to employ salesmen to specialize on industrial business. In order to induce manufacturers' agents to employ such salesmen, it might be necessary for the Stanhope Company to take the risk involved in guaranteeing the salesmen's compensation, at least for an initial period.

One official believed that the past development of the company's business indicated that its existing distribution system was basically sound. He favored making efforts to stimulate the company's existing channels and sales organizations to push sales in the industrial market more vigorously.

What steps, if any, should the officers have taken to improve the position of the Stanhope Company in the industrial market?

6. GRADY OIL COMPANY

CHANNELS OF DISTRIBUTION FOR NEW PRODUCT

The Grady Oil Company manufactured specialty chemicals such as lubricants, rust-preventive oils, oils for drawing metals, penetrating oils, and a plastic seal for pipes. The company limited its sales of operating and maintenance supplies for factories to industrial supply firms throughout the United States. Inventors realized that the company desired new products to offer to its special market, and constantly were bringing new ideas to the company. About one of every 100 of these items was used by the firm. The company made extensive tests of new products before adding them to its line.

In 1932, there was brought to the attention of the officers of the Grady Oil Company a new type of paint made of casein, a derivative of milk. The paint, which was sold in paste form, was made ready for use by the mixture of one part of the paste and one-half part of water.

The inventors of the casein paint asserted that as an interior flat paint their product was superior to other products then on

the market. It was common knowledge in the paint trade that any white paints which contained linseed oil turned yellow after a certain length of time, no matter how expensive the ingredients used. Such paints, furthermore, were difficult to apply, since their high viscosity meant that painters had to brush the surface several times before the paint was spread evenly, and anything larger than a 5-inch brush was difficult to use. Thus the labor cost of painting with oil paints was high. The new casein paint, according to an executive of the Grady Oil Company, eliminated the difficulties of the interior paints then in use. Since the casein paint contained no oils and nothing but white materials of high quality, it could not turn yellow. In most instances, one coat was all that was needed to give a lasting whiteness, whereas it was the practice to use at least two coats of ordinary oil paints. The low viscosity of the casein paint permitted an even application with brushes as large as 12 inches. Other advantages of the new product were that it could be sprayed evenly, could be applied to a damp surface, dried in 30 minutes, had no odor to penetrate foods, could be applied by unskilled labor, could be tinted easily, and gave over 90% light reflection.

Since the casein paint would not stand outdoor weather, the officers of the company believed that, if the casein paint was marketed, it would have to be supplemented with a paint designed for outdoor use. To fill this need the management considered aluminum paint, which also would be prepared in one grade and in one color.

Before reaching a decision on the addition of the paints to its line, the management decided to investigate the competitive situation for these two products. It found that five other concerns were making casein paint; two sold in all states, while the other three served local areas only. None of these concerns had been in the paint business for any length of time. The aluminum paint industry presented a different situation. A great number of concerns were already making aluminum paints. All of them purchased the basic ingredient, aluminum paste, from the Aluminum Company of America, but mixed the paint according to their own specifications.

A survey of the industrial paint field convinced the Grady executives that there was a definite place for a new producer of these two paints. They found that over half the paints sold in

the United States were used by the industrial market, and they believed that they could convince many industrial users of interior paints of the superiority of the casein paints to the products which they were using.

Once having decided to add casein and aluminum paints, the officials of the Grady Oil Company considered channels of distribution for the products. The existing distribution practices in the paint industry were studied with the aid of a brochure entitled *A Survey of the Industrial Markets for Paints.*[1] This study, as summarized in Exhibit 1, indicated that industrial paint was purchased largely direct from paint manufacturers.

EXHIBIT 1

DISTRIBUTION OF PURCHASES OF PAINT AS PERCENTAGES OF TOTAL VOLUME OF PAINT SOLD

Direct from Manufacturer	76%
Paint Contractors	10
Local Dealers	7
Jobbers	6
Mill Supply Houses	1

Officials of the company ascertained that its two large competitors in the casein paint field, in addition to selling direct to industrial users, sold also to mill supply firms, to paint wholesalers, and to hardware stores. These companies seemed to have no consistent distribution policies, but sold to anyone who promised them even temporary volume.

The survey of the industrial paint market seemed to indicate that mill supply houses, through which the Grady Oil Company had been distributing its products in the past, would not be satisfactory outlets for paints. In addition to the facts shown in the survey, the executives knew that the duties of the salesmen of these supply firms were those of order takers. Hence there was some question whether these salesmen had the time or the ability to sell paint. Nevertheless, the officers believed that there were factors involved in the distribution of the new paints, particularly the casein products, which might make it desirable to sell through these outlets.

The executives of the Grady Oil Company were convinced that the supply-firm salesmen would be able to sell casein and aluminum

[1] Published by the Marketing Counsel Staff of the McGraw-Hill Publishing Company, Inc., 1928.

paints to industrial users as effectively as the salesmen of paint manufacturers. The supply-firm salesmen called on customers as often as once a week, whereas the salesmen of most paint companies called only three or four times a year; consequently the salesmen of the supply firms were expected to have an advantage in selling because their calls were likely to coincide with the need of customers for paints. In addition, salesmen needed no technical knowledge of casein paint, since it was not affected by the usual factory fumes and gases which made the prescription of oil paints so difficult. This lack of technical knowledge of paints and their application had formerly handicapped salesmen of supplies in selling oil paints.

The management also expected the limited line of Grady paints to appeal to supply firms. The latter had objected to the large investiments required for a full line of oil paints. The Grady Oil Company was to sell just one grade of casein paint in one color, pure white, in four different sizes of containers, varying in capacity from 1-quart cans to 30-gallon drums. Ultimate users were to mix tints when needed; they were expected to buy the tints from supply firms or hardware stores, since the Grady Oil Company did not plan to sell them. The aluminum paint also was a one-color line, and it was to be packaged in four sizes only.

Officials of the Grady Oil Company realized that they were acting contrary to the established practice of the industry when they decided to sell paint through industrial supply firms. The officers believed, however, that the company could not afford to sell direct to industrial users. Salesmen could sell paint to supply firms in connection with routine calls, but to reach large users by direct sale would require a new set of contacts and more salesmen. The officials of the company realized, further, that the entire success of this type of distribution depended on the manner in which the plans were carried out; they believed that their plans would fail if their relations with the mill supply firms were not handled properly.

In its established business the company had been represented by over 500 mill supply firms, none of which had been given an exclusive agency. For the new products, the company decided to use more selective distribution. Therefore the Grady Oil Company asked the leading supply firm in each large city to sell its

paints under an arrangement whereby that firm was to be the only one selling the paints in the city. In addition, the company agreed not to sell direct to the industrial users of the area. By 1934 over 150 such representatives had been obtained. Most of these supply firms sold to all types of industrial concerns, although firms located in regions where particular industries were concentrated naturally were specialists in those fields. As a result of giving supply firms protected territories, the Grady Oil Company expected its paints to be pushed aggressively.

For over a year, one of the officials of the company spent his entire time calling on these supply firms. He showed them the industrial advantages of the company's paints and emphasized the fact that a supply firm's investment in inventory of Grady paints was comparatively small. He was able to indicate that, when distributors carried a stock of oil paints in the required number of colors and qualities, an investment of as much as $2,000 was often necessary, but that, because each of the Grady paints was manufactured in only one grade and color, an investment of $150 worth of each was sufficient.

In setting its initial prices for paints, the Grady Oil Company allowed a margin above 1933 costs for expected advances in raw material prices. The management considered the maintenance of a uniform price a strong factor in influencing reliable mill supply firms to stock its paints. The competing paint companies were constantly engaged in price wars, with the result that the distributors' profits were unstable. The list prices set by the Grady Oil Company were as shown in Exhibit 2. These prices could not be compared directly with the list prices of oil paints, for there were many different grades of oil paints and several levels of list prices. Purchasing agents realized that the price situation was chaotic and that paint quality could not always be depended on; thus many bought their requirements on specifications. The Grady Oil Company set its list prices high enough to allow discounts of 25% and 33⅓%. Supply firms gave customers 25% off list and retained the 33⅓% as markup.

The Grady Oil Company used 22 salesmen of its own to promote sales. These men were expected to work with the mill supply salesmen as much as possible, to train them in methods of selling, and to see that they carried sample cans of paint on their trips. The company salesmen also called on large users of paints, and

EXHIBIT 2
GRADY OIL COMPANY
List Prices of Paint Products
(Per gallon)

Casein Paint:	
Drum (30 gallons)	$2.40
Drum (5 gallons)	2.60
Case (1-gallon cans, 6 to a case)	2.75
Quart Cans (12 to a case)	4.00
Aluminum Paint:	
Drum (55 gallons)	3.50
Drum (30 gallons)	3.60
Drum (5 gallons, double compartment)	3.95
Case (1-gallon cans, 6 to a case)	4.25

were required to check up on all complaints received by the company. From the home office of the company, directions were mailed to the salesmen at least twice a week. In addition, copies of all sales literature of the company were sent to these men. Three of the salesmen worked full time for the company. They received a 10% commission on their sales and were guaranteed a minimum salary. The other salesmen were paid a straight 10% commission on sales in their districts. Since the Grady Oil Company's products did not create enough sales volume to warrant employing these men full time, they were allowed to represent two or three other firms that sold noncompeting items to the same outlets.

Every two weeks the company mailed a multigraphed letter to the sales managers of supply firms. These letters were intended to keep the men in charge of the selling reminded of Grady products. The company did not send letters to the salesmen of the mill supply firms; once a month, however, a reminder card, which carried merely the name of the product and a statement of one of its particular advantages, was mailed to those salesmen.

The officers of the Grady Oil Company were sure that sales work among the mill supply firms alone was insufficient to sell its paints. The industrial users of the paints also had to be approached directly. The officials realized that the method of distribution did not permit sales to some large companies which almost never dealt with mill supply firms except in emergencies but insisted on buying direct from manufacturers. In order to promote sales of Grady paints to industrial users, the company intended to send a multigraphed letter once a month to the 50 best customers of each mill supply firm. The officers realized that some of the supply firms would not be willing to divulge the names of customers;

but in such cases, it was expected that the supply firms themselves would be willing to mail the letters. Special letters to members of selected industries were also planned. The company estimated that, including postage, direct-mail costs would be 5 cents a letter.

Since Grady products were designed to fill the maintenance needs of industry, the executives desired to use trade papers that would reach the men responsible for such purchases. The magazine *Mill and Factory* was considered desirable for that purpose. This was a controlled-circulation magazine, the circulation list of which was obtained from the customer lists of mill supply firms. Each supply firm was allowed to have an advertisement on the front page of those copies of the magazine which went directly to its list of names. Since the supply companies knew the names of those men who should be reached in each industrial concern, the publishers believed that the magazine reached the persons whom advertisers of maintenance goods ought to reach. Because the supply firms paid the publishers several cents for each name placed on the list, the supply firms usually kept the mailing list up to date. The Grady Oil Company bought one page every two months in this magazine, at a cost of $186 per page.

The company also advertised regularly in *Industrial Equipment News*, a monthly paper established by the publishers of *Thomas' Register of American Manufacturers*. One-ninth page of advertising in each issue was purchased at a cost of $69 an issue. This paper carried very little editorial matter but was intended to be a catalogue of new maintenance products. It went to executives in charge of maintenance in all concerns with an "A" rating or above in *Thomas' Register of American Manufacturers;* thus it reached concerns with a capital of $100,000 or more. The Grady Oil Company received very satisfactory results from its advertising in these magazines. A number of inquiries were received, all of which were followed up by the company's salesmen.

Every effort was made to coordinate the actions of the company's salesmen and the mill supply salesmen with the direct-mail and magazine advertising. The salesmen were given copies of the advertising, and were expected to note reactions of the customers to this publicity.

The Grady Oil Company had not expected to earn a profit on its paints for at least two years. The only out-of-pocket new expenses incurred by the addition of the casein paint were $600

for direct mail and $1,944 for space advertising. The company planned to ignore the salary and expense of the traveling executive, because he made his calls regularly anyway for the benefit of existing lines of merchandise. Other office costs were not increased by the addition of the paint line. Sales commissions were proportional to sales. In order to operate without a loss of out-of-pocket expenses, the company had to sell 8,500 gallons in 1934; through July, 1934, 15,000 gallons had been sold.

What factors were chiefly responsible for the Grady Oil Company's apparent success in marketing the new types of paint?

7. HOLSER COMPANY

SELECTION OF CHANNELS FOR BIDDING ON GOVERNMENT ORDERS

In August, 1940, the Holser Company, a manufacturer of building materials, was considering whether it should bid direct on government orders or submit bids through its dealers.

The Holser Company manufactured a line of building materials, including roofing, building paper, and wallboard. Annual sales of the company were approximately $7,000,000, of which the roofing line represented about 90%. The company sold its products throughout the United States. Its sales staff included the sales manager and seven divisional sales managers, each of whom controlled a force of 7 to 20 field salesmen.

The largest single demand for the Holser Company's products was in the replacement market for residential roofing. Inasmuch as a new roof cost $100 or more, it was a major item in a consumer's budget and usually was purchased only after some investigation. Sales of reroofing, however, rarely originated solely on the initiative of house owners. The Holser Company had found that contractors specializing in roofing and reroofing were becoming increasingly active. These contractors made surveys of the houses in their respective territories to locate owners possibly in the market for roofing, and sold not only the materials but the complete roofing job. Consumers were inclined to rely on the reputation of the contractors and to accept their judgment as to the suitability of various types of materials. Roofing contractors customarily

purchased these materials from building supply dealers. In many cases, the latter also had established their own contracting departments to apply roofing.

The work of the company's salesforce could be divided into two phases: (1) The field salesmen approached applicators of roofing, builders, and architects for the purpose of developing a demand for the Holser Company's products in preference to other brands of roofing material; (2) the salesmen attempted to obtain additional dealers in building materials in order to have the Holser Company's roofing widely available when ordered by the applicators. In any territory there was usually a close relationship between the building supply dealers and the contractors or applicators; and as indicated, in many cases the two functions were combined in one firm.

The Holser Company estimated that approximately 50 firms in the United States manufactured products similar to its own. Of this number, a dozen firms were well known. Some of these companies did extensive consumer advertising and had strongly established brand names. For its sales promotion, however, the Holser Company relied primarily on building up the goodwill of its dealers. It did some local advertising with its dealers, since recognition of Holser products by dealers and consumers was valuable in offsetting the price appeal used by many of the producers of building materials.

Most building supply dealers preferred to carry only one line of roofing. In view of the reliance that consumers placed on the judgment of contractors in selecting building materials, the standardized nature of many building materials, and the substantial consumer recognition which some other brands had attained, the Holser Company realized that its dealers could switch to another line of roofing without suffering any serious loss of trade. The company in that event would lose the benefits of most of the promotional work which its salesforce had done with the applicators, since the latter would presumably shift fairly readily to the products of another manufacturer if the dealer did so.

The Holser Company's products could be used by the United States government in temporary or permanent construction work. Almost any of the government agencies were potential purchasers of building materials: the Army, the Navy, the Marine Corps, the Civilian Conservation Corps, and so on. Contracts with these

agencies were customarily awarded on the basis of competitive bidding. Inasmuch as government specifications for roofing materials were well established, the question of price was extremely important. Until the summer of 1940, the small volume of business which the Holser Company had done with the government had been handled locally by the dealers rather than direct by the Holser Company. Most of such business had been in l.c.l. lots. In view of the need of extensive construction work on barracks and other structures for the government, involving substantial quantities of roofing material for each project, the company wished to establish a policy with regard to handling such business.

One method by which the Holser Company might handle government inquiries was to allow the building supply dealers to bid, with the company itself refraining from bidding direct. No matter which agency of the government issued the invitation to bid, delivery of the materials at a specific point was required, a situation which made the order of primary interest to the dealer in the territory where the construction was to be done. By handling government bids through its dealers, the Holser Company would be following its established selling policy. The company had spent considerable effort in developing its contacts with dealers and was anxious to retain their goodwill. The management knew that the dealers would expect to handle the materials for some of the construction work for the government in their respective territories. Since a government order involved no credit risk and could be handled with little expense, the profit on such business would compensate the dealers for their efforts in handling some of the more difficult competitive problems encountered in the ordinary course of selling the Holser Company's products. Also the executives realized that the increasing requirements of national defense would eventually bring about a drastic curtailment of private construction, and they were concerned as to what might happen to the business of their dealers under such circumstances.

On the other hand, certain factors favored the Holser Company's handling at least some of the bids on government business direct and not through its dealers. The company realized that the production costs of most of the important producers of comparable building materials were approximately equal. Consequently, since production would be to government specification, price competition would be intense. If the company desired to obtain

government orders, it stood a far better chance of doing so by quoting prices direct and thereby eliminating from the bid any margin that a dealer might add. Furthermore, since the company did not incur certain costs on direct government business which it incurred in its normal commercial operations, it could quote prices lower than those quoted to its regular trade.

Another factor which the Holser Company had to consider in determining the desirability of bidding direct on government orders arose from the government's procedure in issuing invitations to bid. These invitations might be issued from any one of a number of government agencies, each of which had a list of potential suppliers of the materials desired. If an agency issued invitations to a company and received no bid for five consecutive times, it removed the company's name from the mailing list. Such action, if it was taken against the Holser Company, would be detrimental, even if the company handled all government orders through its dealers. By receiving an invitation to bid, the Holser Company would be able to learn the details of the proposed order as soon as its competitors did and thus could make cost estimates promptly. If it was necessary for the company to rely on dealers to relay to it information on the invitations that they received, considerable time would be lost.

Certain compromises in the policies indicated were also open to the Holser Company. There had been a strong feeling among building supply dealers against manufacturers' underbidding them. In order to include the dealers in the government business and still be able to quote a low price, the Holser Company considered bidding direct but allowing the dealers concerned some type of commission on such orders. Another possibility was to quote to the dealers special prices to be used on specific government orders. If the Holser Company adopted either of these methods, it would encounter certain difficulties. Since building supply dealers, especially in metropolitan areas, did not have exclusive agencies for the sale of the Holser Company's products, several dealers might be concerned in any one government order. This situation would lead to disputes as to which dealer should receive the commission or special price quotation.

Instead of merely asking for bids on building materials separately, in many instances of large projects the government agencies called for bids on complete construction jobs, including roofing materials

and application. Such orders were mainly of interest to large general contractors. On these inquiries, although the Holser Company would have to deal with the contractors instead of with the government, it would still face the problem of deciding whether to quote prices direct to the contractors or to sell to them only through its dealers.

What policies should the Holser Company have established with respect to the channels for bidding on government orders?

VI

BRAND POLICY

1. SOME NOTES ON TRADE-MARK LAW

Trade-marks and trade-mark registration are described as follows in a pamphlet published by the U.S. Patent Office:[1]

A trade-mark is a distinctive word, emblem, symbol, or device, or a combination of these, used on goods actually sold in commerce to indicate or identify the manufacture or seller of the goods. The mark must have been used in interstate or foreign commerce, or in commerce with the Indian tribes, *before* an application for registration can be filed in the Patent Office.

A trade-mark cannot be registered if it contains immoral or scandalous matter. No one can register a mark including the flag or coat of arms or other insignia of the United States or any simulation thereof, or of any State or municipality or of any foreign nation, or of any design or picture that has been or may hereafter be adopted by any fraternal society as its emblem. Registration is prohibited of any name, distinguishing mark, character, emblem, colors, flag, or banner, adopted by any institution, organization, club, or society which was incorporated in any State of the United States prior to the date of adoption and use by the applicant, provided use by the organization was prior to use by applicant. No portrait of a living individual may be registered as a trade-mark except by the written consent of the individual, nor may the portrait of any deceased President of the United States be registered during the life of his widow except by written consent of the widow. No mark which is identical with that used by another on the same class of goods, or so nearly resembles it as to be likely to cause confusion in trade, can be registered. These limitations do not prevent the registration of a trade-mark merely because it is the name of the applicant, provided it is distinctively written or printed.

Any mark which has been in actual and exclusive use as a trade-mark by the applicant during the 10 years next preceding February 20, 1905, may be registered, and such a mark when once registered may be reregistered when used on other goods of the owner of the mark.

Trade-marks are not protected by the copyright laws.

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[1] *General Information about Protection of Trade-marks* (Washington, Government Printing Office, 1940), pp. 1–4. In 1942 a comprehensive revision of trade-mark legislation was under consideration by Congress.

Trade-marks in general are registered under the act of February 20, 1905, but no mark can be registered under this act which consists merely of the name of an individual, firm, corporation, or association, unless it is written or printed in a particular or distinctive manner, or in association with a portrait of the individual. Nor can mere words or devices descriptive of the goods with which they are used or the character or the quality of such goods be registered; nor may a mere geographical name or term be registered under the act of 1905. These marks, however, may be registered under the act of March 19, 1920, if they have been in actual, bona fide use as a trade-mark in interstate, foreign, or Indian commerce at least one year prior to the date of filing the application for registration. An application filed under the 1905 act may be changed to the 1920 act and vice versa.

. . . .

The office cannot give advice as to whether the owner of a mark should apply for registration thereof, or whether it is already used by another. Nor can the office, in advance of the filing of an application, make searches to determine the registrability of a mark. The office, however, has a trade-mark digest open to the public, consisting of an alphabetical list of registered words, and a classification of symbols, birds, animals, etc., as well as a set of trade-marks arranged according to the goods with which they are used. It is advisable to search here before adopting a trade-mark so as to avoid conflict. The office has a card index of articles of commerce indicating their classification in the 50 classes of goods which have been established under the law.

. . . .

The office, ordinarily, does not pass upon the applicant's right to use the mark, but determines only the right to registration. Registration does not create the right to use the mark but gives prima facie right to prevent others using it. Ownership of a trade-mark arises from its use, so it must be used *before* it can be registered.

An applicant does not lose any common law right he may have by applying for registration of his trade-mark. Under the common law a trade-mark is the property of the party who can prove the earliest date of use.

Registration under the act of February 20, 1905, gives prima facie evidence of ownership, the right to sue in the United States courts with increase of damages and destruction of infringers' labels, etc., together with the right to prevent importation of goods bearing an infringing mark.

Registration under the act of March 19, 1920, does not give prima facie evidence of ownership, but does give the right to sue in the Federal courts.

On complying with regulations of the Treasury Department and filing there a certified copy of a registered mark the collectors of customs will prohibit importation of foreign goods copying or simulating the mark.

Many foreign countries will not register a mark for a citizen of the United States unless it is registered in the United States Patent Office.

. . . .

The registration of a mark protects not only that mark but any mark so like it as to cause confusion or mistake or to deceive purchasers.

A registrable mark is one used with merchandise. The law makes no provision for the registration of marks used only in connection with service, such as insurance, bonding, banks, collection agencies, laundry work, cab service, and the like.

. . . .

Applicants are advised to employ competent attorneys in all trade-mark matters.

PROPER NAMES AND GEOGRAPHICAL NAMES IN TRADE-MARKS

The use of trade-marks which include proper names or geographical names, or which consist solely or largely of such names, has given rise to litigation. Some years after the Royal Baking Powder Company had made its trade-mark well known, a man named Royal began manufacturing baking powder, displaying his name in large letters on the package. A bill of injunction was brought by the Royal Baking Powder Company, alleging infringement. The court decided that the defendant had the right to market baking powder under his own name; he had, however, to distinguish the appearance of his label from that of the Royal Baking Powder Company and to print his name in full on the package.[1]

In the Chickering case the court imposed a more substantial restriction on the use of a proper name. The name "Chickering" had come to be associated with pianos made by the plaintiff. The defendant, Chickering & Sons, was manufacturing "Chickering Pianos." The court granted the plaintiff the right to use the name "Chickering" exclusively as a trade-mark for pianos because of the "secondary meaning" which the name had acquired in the public mind.[2]

In another of the many cases relating to proper names, the court allowed the use of the proper name by a second firm, provided the trade-mark included a notice of differentiation. The plaintiff, the John B. Stetson Company, had long sold hats under the name "Stetson." The trade-mark used by the defendant, The Stephen

[1] *Royal Baking Powder Co. v. Royal*, 122 Fed. 337 (1903).
[2] *Chickering v. Chickering & Sons*, 215 Fed. 490, 4 T.M. Rep. 279 (1914).

L. Stetson Company, was quite dissimilar to that of the plaintiff and included the name "Stephen L. Stetson" displayed prominently. In this case an attempt was made to determine scientifically whether purchasers confused the Stephen L. Stetson brand with the older Stetson brand. At the request of counsel for the John B. Stetson Company, a survey was conducted by Neil H. Borden, Professor of Advertising in the Harvard Graduate School of Business Administration; this survey showed that a very large proportion of the men interviewed did, in fact, confuse the newer with the older brand.[1] The findings were excluded by the court, however, when objection to their admission was made by defense counsel. In its ruling, the court showed the same hesitancy to admit such evidence as had other courts in similar circumstances. The judge said, "I think it is a kind of solidified hearsay, if I may put it that way, that you have got and that you ask me to take." The defendant, nevertheless, was enjoined from using in any connection with the advertising of his product the word "Stetson" unless accompanied by a notice of differentiation whose nature, including the larger letters and bolder type, was specified by the court as follows:[2]

Stephen L. Stetson Co., Ltd.
Incorporated 1933
NEVER CONNECTED IN ANY WAY
With
John B. Stetson Company
Or Its Predecessors
Hat Makers in Philadelphia
Since 1865

A case which has influenced courts in the United States with respect to the doctrine of secondary meaning as related to geographical names was the famous decision of the House of Lords concerning the phrase "Stone Ale" for beer.[3] The respondent came to the town of Stone, where the complainant was producing its well-known "Stone Ale," and began to produce beer under the same name. The respondent claimed that the water in Stone was peculiarly adapted to the production of beer. He argued,

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[1] See Neil H. Borden, *Determination of Confusion in Trade-mark Conflict Cases* (Harvard Business School, Division of Research, Business Research Studies 16, 1936).

[2] *John B. Stetson Co. v. Stephen R. Stetson Co.*, 14 F. Supp. 74 (1936).

[3] *Montgomery v. Thompson*, A. C. 217 (1891).

further, that all that was needed to avoid confusion among beer drinkers was a statement on the label of the bottle to the effect that his business was in no way connected with that of the complainant, that is, by the addition of a notice of differentiation. This argument was rejected flatly by the House of Lords in an opinion containing what has become a famous sentence, "Thirsty folk want beer, not explanations."

In the Waltham Watch case[1] the problem was stated by Mr. Justice Holmes thus:

> It is desirable that the plaintiff should not lose custom by reason of the public mistaking another manufacturer for it. It is desirable that the defendant should be free to manufacture watches at Waltham, and to tell the world that it does so. The two desiderata cannot both be had to their full extent, and we have to fix the boundaries as best we can.

The court decided that the plaintiff had made the name "Waltham" so well known for watches that the word indicated the plaintiff's article and not the geographical location of manufacture. Therefore, the court ruled the mark "Waltham" a valid common-law trade-mark and enjoined the defendant from using the word "Waltham" as a trade-mark and from advertising its watches under that name. The defendant was further forbidden to put the word "Waltham" on the dials of the watches but was allowed to put the words "Waltham, Mass." on the inner plates of the watches.

DESCRIPTIVE AND DECEPTIVE WORDS AND PHRASES IN TRADE-MARKS

Words and phrases which are merely descriptive of a product or its qualities are not registrable as trade-marks although litigation sometimes arises with respect to whether a word or phrase is merely descriptive. The main rule, however, is plain, as indicated, for example, in the Hercules Powder case.[2] The Hercules Powder Company petitioned Newton, Commissioner of Patents, to register the trade-mark "Infallible" for use on smokeless powder. Commissioner Newton refused to grant registration of this trade-mark, and the company brought suit to compel such registration. In upholding the commissioner in his decision that "Infallible" was

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[1] *The American Waltham Co. v. United States Watch Co.*, 173 Mass. 85 (1899).
[2] *Hercules Powder Co. v. Newton*, 266 Fed. 169 (1920).

not registrable as a trade-mark for smokeless powder, the court said:

The fundamental inquiry is this: Does the suggested trade-mark word or device, with the environment proposed for it, convey by its primary meaning something which others may employ with equal truth and equal right for the same purpose?

The basic legal doctrine relating to deceptive words and phrases was laid down many years ago in the Syrup of Figs case.[1] In that case, the California Fig Syrup Company, which manufactured a laxative called "Syrup of Figs" or "Fig Syrup," sought to prevent the sale by Worden of a similar product under the same names. The facts showed that "Syrup of Figs" contained "just a suspicion" of fig juice, put in not for medicinal purposes, since the active ingredient was senna. The lower court sustained the request, but the United States Supreme Court, in reversing the decree, said:

Upon such allegations and the admissions of the complainant's principal witness, some of which are hereinbefore quoted, and upon the entire evidence in the case, and in the light of the authorities cited by the counsel of the respective parties, our conclusions are that the name "Syrup of Figs" does not, in fact, properly designate or describe the preparation made and sold by the California Fig Syrup Company, so as to be susceptible of appropriation as a trade-mark, and that the marks and names, used upon the bottles containing complainant's preparation, and upon the cartons and wrappers containing the bottles, are so plainly deceptive as to deprive the complainant company of a right to a remedy by way of an injunction by a court of equity.

The difficulties associated with the determination of what are and what are not descriptive and deceptive phrases are well reported by Zechariah Chafee, Jr., Langdell Professor of Law in the Harvard Law School:[2]

. . . Such marks are illustrated by an argument once filed by Mr. Rogers in the Patent Office. He was seeking to register "Limestone Brand" as the trademark for a cathartic medicine. The examiner first denied the application on the ground that the mark was descriptive, assuming that the medicine contained limestone, as though anybody would want to take that as a cathartic. When Rogers wrote back and said that there was no limestone in the medicine, then the examiner said that the

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[1] *Clinton E. Worden & Co. v. California Fig Syrup Co.*, 187 U.S. 516, 23 S. Ct. 161 (1902).
[2] "Unfair Competition," *Harvard Law Review*, Vol. 53 (1940), p. 1294.

mark was deceptive and hence against public policy. So Rogers prepared a remarkable brief including these statements:

"Ivory is a good trademark for soap not made of ivory. Gold Dust Washing Powder is not made of gold. Old Crow Whiskey is not distilled from crows. There is no bull in Bull Durham. Royal Baking Powder is not used exclusively by royalty, nor is Cream Baking Powder made of cream. Pearline contains no pearls and White Rock is water. There is no cream in cream of tartar, in cold cream or in chocolate creams, no milk in milk of magnesia, in milkweed or in the cocoanut. These are all as remote from the cow as the cowslip. There is no grape in grapefruit or bread in breadfruit. A pineapple is neither pine nor apple; a prickly pear is not a pear; an alligator pear is neither a pear nor an alligator, and a sugar plum is not a plum. Apple-butter is not butter. All the butter is taken out of buttermilk, and there is none in butternuts, or in buttercups, and the flies in the dairy are not butterflies."

And still the examiner denied the application.

TERRITORIAL CONFLICTS OF TRADE-MARK RIGHTS

Since ownership of a trade-mark is acquired by use and not by registration, the possibility arises that two or more persons may have been using the same trade-mark on the same type of product in different parts of the United States. These cases present difficult problems, and the law is by no means crystal clear.

The Hanover Star Milling Company, an Illinois corporation, used the trade-mark "Tea Rose" on flour, which it sold in Alabama, among other places. This corporation was in competition with the Steelville Milling Company of Illinois and the Allan & Wheeler Company of Troy, Ohio. Metcalf, agent of the Steelville Milling Company, began selling flour in Alabama under the name "Tea Rose." When suit was brought by the Hanover Star Milling Company, Metcalf showed that the Steelville Milling Company had used this mark for several years and contended that, in any event, the Allan & Wheeler Company had used the trade-mark "Tea Rose" before the Hanover Star Milling Company had used it. None of the parties to these suits had registered the name "Tea Rose."

The Allan & Wheeler Company also brought suit against the Hanover Star Milling Company for infringement of trade-mark, and both cases finally were brought up together in the United States Supreme Court.[1] It was shown that the Hanover Star Milling

[1] *Hanover Star Milling Co. v. Metcalf*, 240 U.S. 403 (1916).

Company had developed the southern territory of Alabama and neighboring states to such an extent that the Allan & Wheeler product was virtually unknown. Therefore, the Allan & Wheeler Company was held to be estopped from asserting trade-mark infringement in this territory. In addition, the Hanover Star Milling Company was granted its complaint against Metcalf on the grounds that the Steelville Milling Company never had developed the southern territory.

Thomas G. Carroll & Son Company used the trade-mark "Baltimore Club" on its rye whiskey sold in Baltimore under trade-mark registration granted in 1870. In 1868 McIlvaine & Baldwin, Inc., used the same trade-mark on its whiskey and thereafter built up a large business in New York City. When Thomas G. Carroll & Son Company extended its business to New York City it sought an injunction against McIlvaine & Baldwin, Inc. The injunction was refused by the court, which said:[1]

> Under the present trade-mark act [1905] a certificate of registration is prima facie evidence of ownership; but this evidence may be contradicted in court, and the apparent right of the registering party shown not to exist. Registration cannot confer a title to a trade-mark, if some other individual has acquired a prior right by adoption and use; nor can it vest a title in the registrant as against another's common-law title.

In the Rectanus case a few years later the court reaffirmed the same principle:[2]

> It would be a perversion of the rule of priority to give it such an application in our broadly extended country that an innocent party who had in good faith employed a trade-mark in one state, and by the use of it had built up a trade there, being the first appropriator in that jurisdiction, might afterwards be prevented from using it, with consequent injury to his trade and good will, at the instance of one who theretofore had employed the same mark, but only in other and remote jurisdictions, upon the ground that its first employment happened to antedate that of the first-mentioned trader.

The Western Oil Refining Company, an Indiana corporation, sold a high-grade gasoline in Ohio. Since 1917 it had used the trade name "Silver Flash." In 1923 Frank Jones, operating under the name of Ohio Valley Oil Company, began selling gasoline

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[1] *Thomas G. Carroll & Son Co. v. McIlvaine & Baldwin, Inc.*, 171 Fed. 125 (1909).
[2] *United Drug Co. v. Theodore Rectanus Co.*, 248 U.S. 90 (1918).

at Wellsville and East Liverpool, Ohio, under the same trade name. In deciding this case, the court enunciated what may be called the "normal expansion" doctrine of protection:[1]

> The name "Silver Flash," as used by appellant, is, in our opinion, a registrable trade-name. Appellee does not contend that it is not or that appellant has not established the right to its exclusive use in certain sections of the country, but contends that it has not established that right in and around Wellsville and East Liverpool, where the alleged infringement occurred. The argument in support of this point is based upon the principle of territorial limitation recognized in *Hanover Milling Co. v. Metcalf* . . . and *Rectanus Co. v. United States Drug Co.* . . . Those limitations, in our opinion, do not exclude territory which may be reasonably expected to be within the normal expansions of the business. Such expansions as to a trade-name for gasoline, in view of modern transportation methods and the fact that many purchasers are travelers from a distance, would ordinarily embrace at least the entire state, in which there had been a widespread advertisement and use of the name in the major part of the state. There had been such use by appellant of its name, and although it had not sold gasoline in either of the places where appellee was engaged in business, it is entitled, we think, under the principle stated, to the exclusive use of the name in both of those places.

TRADE-MARKS WHICH BECOME GENERIC NAMES

Some interesting cases arise where a trade-mark which is essentially a name of a patented article or a product made with patented equipment becomes the generic name for the product. The basic rule was laid down in the Singer case,[2] in which the court said:

> The result, then, of the American, the English, and the French doctrine universally upheld is this: That where, during the life of a monopoly created by a patent, a name, whether it be arbitrary or be that of the inventor, has become, by his consent, either expressed or tacit, the identifying and generic name of the thing patented, this name passes to the public with the cessation of the monopoly which the patent created. Where another avails himself of this public dedication to make the machine and use the generic designation, he can do so in all forms, with the fullest liberty, by affixing such name to the machines, by referring to it in advertisements, and by other means, subject, however, to the condition that the name must be so used as not to deprive others of their rights, or to deceive the public; and, therefore, that the name must be accompanied with such indications that the

[1] *Western Oil Refining Co. v. Jones*, 27 F. (2d) 205 (1928).
[2] *Singer Manufacturing Co. v. June Manufacturing Co.*, 163 U.S. 169, 199 (1896).

thing manufactured is the work of the one making it, as will unmistakably inform the public of that fact.

The National Lock Washer Company manufactured lock washers under a patent granted to Harvey. This patent expired in 1903. Thereafter the Hobbs Manufacturing Company began making similar washers and selling them under the designation "National Pattern." The National Lock Washer Company sought to enjoin this use of the word "National." Ruling adversely, the court said:[1]

The defendant contends that this case is governed by the decision in *Singer Manufacturing Co. v. June Manufacturing Co.*, 163 U.S. 169, 16 Sup. Ct. 1002, 41 L. Ed. 118; that under the rule of that case, upon the expiration of the Harvey patent in 1903, the word "National," as applied to lock washers constructed under that patent, became public property, and that it had the right thereafter to make lock washers covered by the patent and to sell them under the designation of the National pattern, provided it clearly indicated, as it did, that the article it dealt in was of its own manufacture; that neither the patentee nor his successor in title, the complainant, could acquire a monopoly in the word "National" on the theory that it had become a trade-mark denoting origin; that, whether it denoted origin or, by reason of its use during the existence of the patent, had become descriptive of the kind of washer manufactured thereunder, neither the patentee nor his successor could acquire a monopoly in the word by having it registered under the act of 1905 as a technical trade-mark, or as a descriptive word under the 10-year clause; and that its use under the patent, being a monopoly, cannot be availed of as proof for the purpose of extending the monopoly for an additional 20 years by registration under the 10-year clause of the act of February 20, 1905.

This contention meets my approval.

The Shredded Wheat case involved patented machinery. Henry D. Perky took out more than 40 patents connected with machinery for making Shredded Wheat and Shredded Wheat Biscuit. After the basic patent had expired in 1912 the Shredded Wheat Company fought an intermittent court battle with the Kellogg Company, as the latter attempted, from time to time, to market a smaller Shredded Wheat biscuit under its own name. Litigation occurred in United States and Canadian courts. A definitive decision was apparently reached in 1938 when, subsequently to a similar decision by the British Privy Council, the

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[1] *National Lock Washer Co. v. Hobbs Manufacturing Co.*, 210 Fed. 516 (1914).

U.S. Supreme Court declared that the National Biscuit Company (which in 1930 had purchased the Shredded Wheat Company) had no exclusive right to use the term "shredded wheat," because that was the generic name of the article and described it to a fair degree of accuracy. Said the court:[1]

Since during the life of the patents "Shredded Wheat" was the general designation of the patented product, there passed to the public upon the expiration of the patent, not only the right to make the article as it was made during the patent period, but also the right to apply thereto the name by which it had become known.

Justices McReynolds and Butler disagreed with the majority, stating that it seemed to them clear that the Kellogg Company was trying fraudulently to appropriate goodwill built up at great cost by the National Biscuit Company.

SIMILAR TRADE-MARK NAMES ON GOODS OF THE SAME DESCRIPTIVE PROPERTIES

Trade-mark ownership gives protection against the use by another of a trade-mark resembling it sufficiently to cause confusion on goods of the same descriptive properties. The determination of such similarity is often difficult.

Holding the trade-mark "Cuticlean" deceptively similar to "Cutex" and its use on substantially similar goods an infringement of trade-mark rights, the court said:[2]

One entering a field of endeavor already occupied by another should, in the selection of a trade-name or trade-mark, keep far enough away to avoid all possible confusion. We can see no purpose or reason for the selection of "Cuticlean" by one entering the field where another is doing a similar business using as its trade-mark "Cutex," except it be done with the hope that benefit might accrue from the similarity. There can be no excuse or justification for such acts.

Whether there is an infringement of a trade-mark does not depend upon the use of identical words, nor on the question as to whether they are so similar that a person looking at one would be deceived into the belief that it was the other; but it is sufficient if one adopts a trade-name or a trade-mark so like another in form, spelling, or sound that one, with a not very definite or clear recollection as to the real trade-mark, is likely to become confused or misled.

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[1] *Kellogg Co. v. National Biscuit Co.*, 305 U.S. 111 (1938).

[2] *Northam Warren Corporation v. Universal Cosmetic Co.*, 18 F. (2d) 774 (1927).

The name "Sammy," registered as a trade-mark for work shirts, was held so similar to the name "Uncle Sam," previously used for many years on work shirts, as to require cancellation of registration. Reversing the decision of the Commissioner of Patents, who had reversed the decision of the Examiner of Interferences, the court said:[1]

The work shirts in question are sold largely to unlettered persons, and the possibility of confusion is greater than when the purchasers are more observant. Moreover, it is likely that some time will intervene between sales made to the same purchaser, with the result that the purchaser's recollection of the exact mark may not be distinct. The names "Uncle Sam" and "Sammy" bear a certain resemblance to each other, and it is not unlikely that customers may mistake the one mark for the other, when applied to exactly the same kind of articles. It may be assumed that, when Feldman & Weinman adopted the word "Sammy" as their mark for work shirts, they were well informed of the good will which Salant & Salant, Inc., had secured for their goods under the mark "Uncle Sam," and the suspicion is unavoidable that they were seeking to benefit from it by means of the resemblance between the two marks. . . .

In *Wm. Waltke & Co. v. Geo. H. Schafer & Co.* (49 App. D. C. 254) 263 F. 650, this court held that the trade-mark "U-Lavo" was confusingly similar to "Lava," as applied to soap. In the court's opinion it is said:

"The reason for this is, as has been said by this court more than once, that the field from which a person may select a trade-mark is practically unlimited, and hence there is no excuse for his impinging upon, or even closely approaching the mark of his business rival. . . . Where he does so, he is open to the suspicion that his purpose is to appropriate to himself some of the good will of his competitor."

In *Guggenheim v. Cantrell & Cochrane, Ltd.* (App. D. C.) 10 F. (2d) 895, it was held that the trade-marks "G & G" and "C & C," as applied to ginger ale, were confusingly similar. The court said:

"In this court, it has been repeatedly declared that there is neither legal nor moral excuse for even an approximate simulation of a well-known mark applied to goods of the same descriptive properties, and that, when an attempt to effect such simulation becomes apparent, the two marks should not be examined with a microscope to detect minute differences, but, on the contrary, should be viewed as a whole, as the general public would view them; in other words, that the points of similarity are of greater importance than the points of difference."

Illustrative of the cases in which registration of a mark consisting principally of a similar word has been allowed is the Vicks

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[1] *Salant & Salant, Inc. v. Feldman & Weinman*, 24 F. (2d) 276 (1928).

case. In 1935 the Vick Chemical Company, owner of the marks "Vicks" and "Vaporub" used on medicaments, petitioned for cancellation of the registration of "Vapex" which had been granted for use on an inhalant for relief of colds. Ruling against the petitioner, the Court of Customs and Patent Appeals said, "We are clear that an inspection of the marks in issue does not reveal a confusing similarity between the mark 'Vapex' and appellant's marks 'Vicks' and 'Vaporub.' "[1]

IDENTICAL TRADE-MARKS ON UNLIKE COMMODITIES

The cases discussed in the preceding section involve the question of the similarity of trade-marks on goods which are admittedly identical or substantially identical.

In this section the problem is the use of admittedly identical or substantially identical trade-marks on unlike commodities—goods which are admittedly not identical—the legal issue being whether the goods possess the "same descriptive properties."

The question of what constitutes goods of the same descriptive properties has been before the courts many times. It has been held, for instance, that shovels and pickaxes,[2] baking powder and baking soda,[3] and toilet brushes and toothbrushes[4] have the same descriptive properties but that cotton cloths as opposed to prints and calicoes,[5] ginger snaps and soda crackers,[6] cheese and butter,[7] and ice cream and milk[8] have different descriptive properties.

In an oft-cited 1925 case, the appellate court granted Rolls-Royce of America, Inc., an injunction against the use of "Rolls-Royce" on radio tubes. The court argued thus:[9]

> From the pleadings and statements made at the argument, it is clear that the purpose of Wall was to take and use the good will, fair name, and trade record which the two companies had, through years of business integrity, given to the name "Rolls-Royce," and thereby create in the minds of the public the impression that his mail order tubes bore some connection with the real Rolls-Royce companies.

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[1] *Vick Chemical Co. v. Thomas Kerfoot & Co.*, 80 F. (2d) 73 (1935).
[2] *The Collins Co. v. Oliver Ames & Sons Corporation*, 18 Fed. 561 (1882).
[3] *Church & Dwight Co. v. Russ*, 99 Fed. 276 (1900).
[4] *Florence Manufacturing Co. v. J. C. Dowd & Co.*, 178 Fed. 73 (1910).
[5] *Amoskeag Manufacturing Co. v. Garner*, 55 Barb. 151 (1876).
[6] *Virginia Baking Co. v. Southern Biscuit Works*, 111 Va. 227 (1910)
[7] *Laurence v. P. E. Sharpless Co.*, 203 Fed. 762 (1913).
[8] *Borden Ice Cream Co. v. Borden's Condensed Milk Co.*, 201 Fed. 510 (1912).
[9] *Wall v. Rolls-Royce of America*, 4 F. (2d) 333 (1925).

Upon no other theory than a purposed appropriation to himself, and an intent to convey to the public a false impression of some supposed connection with the Rolls-Royce industries, can Wall's actions and advertisements be explained. Seeing, then, that by putting his individual business under the name "Rolls-Royce," and utilizing its trade reputation and earned good will, Wall could greatly benefit himself, the converse of the proposition follows: That this veiling of his business under the name "Rolls-Royce" might, and indeed almost surely would, injure the real Rolls-Royce industries, and substantially detract from their good will and fair name. It is true those companies made automobiles and aeroplanes, and Wall sold radio tubes, and no one could think, when he bought a radio tube, he was buying an automobile, or an aeroplane. But that is not the test and gist of this case. Electricity is one of the vital elements in automobile and aeroplane construction, and, having built up a trade-name and fame in two articles of which electrical appliances were all important factors, what would more naturally come to the mind of a man with a radio tube in his receiving set, on which was the name "Rolls-Royce," with nothing else to indicate its origin, than for him to suppose that the Rolls-Royce Company had extended its high grade of electric product to the new, electric-using radio art as well. And if this Rolls-Royce radio tube proved unsatisfactory, it would sow in his mind at once an undermining and distrust of the excellence of product which the words "Rolls-Royce" had hitherto stood for.

In 1927, an appellate court held that ginger ale and fruit beverage were not goods of the same descriptive properties. The court reasoned as follows:[1]

On April 28, 1908, the word "Snap" was registered in the United States Patent Office as a trade-mark for ginger ale under an application filed December 13, 1907, by W. T. Wagner's Sons, a firm domiciled in Cincinnati, Ohio, which stated that applicants "have adopted for its use the trade-mark shown in the accompanying drawing for ginger ale, in class 45, beverages, nonalcoholic." The drawing referred to contained, at the top of the sheet, the following: "W. T. Wagner's Sons. Ginger Ale"—and in the middle of the sheet the single word "Snap." The appellant has not used the word "Snap" in connection with any product marketed by it, other than ginger ale, though it produces and sells other nonalcoholic beverages, including beverages from fruit juices. Appellee produces and markets nonalcoholic beverages from fruit juices under the names "Hamilton's Orange Snap" and "Hamilton's Lemon Snap."

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The evidence did not show that appellee's above-mentioned beverages possessed substantially the same descriptive qualities as

[1] *W. T. Wagner's Sons Co. v. Orange Snap Co.*, 18 F. (2d) 554 (1927).

are possessed by appellant's ginger ale, or any other ginger ale or beverage of the same general class. Appellee's Orange Snap and Lemon Snap are fruit beverages. Ginger ale is not a fruit beverage, and is not a beverage of substantially the same descriptive properties as those of fruit beverages. For two beverages to be of the same general class, it is not enough that each of them is nonalcoholic and contains a principal ingredient derived from a plant, however different the plants may be.

Two beverages are not to be considered as being of the same class, when the general and essential characteristics of them are so different that a person desiring one of them would not be likely to be misled into accepting the other, because the same word is used in its name as is used in the different descriptive name of the one desired. . . . It cannot well be supposed that one would buy a beverage called Hamilton's Orange Snap in the belief that he was getting W. T. Wagner's Sons Company's Snap Ginger Ale. We conclude that, if the appellant had a valid trade-mark in the word "Snap," used with reference to ginger ale, its exclusive right was not infringed by the appellee's use of the same word in its corporate name and in the names of its fruit beverages.

In 1930 the Court of Customs and Patent Appeals handed down the following two decisions, reversing previous decisions of the Commissioner of Patents in which it had been held that various items of merchandise were not of the same descriptive properties.

The B. F. Goodrich Company sought to cancel the Zip-On Manufacturing Company's registration, issued December 2, 1924, of the trade-mark "Zip-On" for use on leggings, knickerbockers, and children's suits, coats, and similar items of clothing, all equipped with "hookless fasteners" similar to those used by the B. F. Goodrich Company on boots and overshoes which, since June, 1923, it had sold under the trade-mark "Zipper," registered in April, 1925. In delivering its opinion that the products of the two manufacturers had the "same descriptive properties" and that the cancellation should be allowed, the court stated that in deciding such a question "the use, appearance, and structure of the articles, the similarity or the lack of similarity of the packages or containers in which, the place or places where, and the people to whom, they were sold should be considered."[1]

The Sun-Maid Raisin Growers of California, which produced dried fruits, syrup, cereals, and other food products, appealed from the decision of the Commissioner of Patents allowing registration

[1] *B. F. Goodrich Co. v. Hockmeyer* (Zip-On Mfg. Co. Substituted), 40 F. (2d) 99 (1930).

by the American Grocer Company of the trade-mark "Sun-Maid" for use on wheat flour. In reversing this decision on the ground that the products of the two companies were of the same descriptive properties, the court said: "The goods of both parties are used for the same purposes—to make bread and pastries. The use of one may suggest the use of the other. They are sold to and used by the same people and some of them are sold in the same kind of containers."[1]

TRADE-MARK INFRINGEMENT AND UNFAIR COMPETITION

The gradual fusing of trade-mark infringement and unfair competition is described by Professor Chafee thus:[2]

> Similarly, a manufacturer's surname could not be monopolized as a trademark unless written in a special way as on Ford cars, because there were other men of the same surname. However, the manufacturer's name does eventually become associated with his wares in the public mind. We all know about Waterman Fountain Pens and Baker Chocolate. Then a large number of Bakers discover that they are called by God to go into the chocolate business, and several Watermans find that their peculiar talents can best be realized in the manufacture of fountain pens. Although there is no technical trademark infringement, the public thinks that it is buying the famous Waterman's pen or the famous Baker's chocolate, when in fact the customer is getting something else. To prevent this wrong to the original Baker or Waterman Company and the public, the courts will compel the interloper to stop using the name altogether, or at least to show that he is entirely dissociated from the well-known manufacturer of the same surname.
>
> Thus the courts came to stop the imitation of devices which through long association with the plaintiff's products had acquired a secondary meaning and become visible symbols of his goodwill, although these devices were not trademarks because they were unaffixed or not sufficiently distinctive. This class of torts was judicially named Unfair Competition. . . .
>
> The last fifty years have witnessed the amalgamation of trademark infringement with Unfair Competition—almost, but not quite. To us the similarity between them seems obvious. In both, the defendant is passing off his goods as the plaintiff's goods by the use of a visible symbol. Whether that symbol be a technical trademark or not, the falsehood is the same and the instinctive response of the customer is the same. The symbol makes him think he is getting something which he is not. In both torts, it makes no difference that the customer would perceive his mistake if he made a thorough examination of the article and asked several questions. . . .

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[1] *Sun-Maid Raisin Growers of California v. American Grocer Co.*, 40 F. (2d) 116 (1930).

[2] Chafee, *op. cit.*, pp. 1296–1298.

An epoch-making article by Handler and Pickett in the *Columbia Law Review* in 1930[1] greatly accelerated the merger. By far the most frequent secondary use cases concerned the imitation of tradenames—geographical, personal, etc., like Waltham or Waterman. Handler and Pickett showed that trademarks and tradenames are now substantially identical. The requirement of distinctiveness for trademarks as compared with tradenames is only a matter of degree. The requirement of affixation of trademarks is disappearing. Fraud has been squeezed out of both kinds of imitation.

. . . .

At the present time, the only important remaining difference between the protection given to trademarks and that given against other forms of passing off concerns registration. Under the Federal Trademark Act, enacted in 1905,[2] only technical trademarks could be registered for the most part. This meant that the United States courts handled trademark infringement as a federal question, whereas their power to deal with secondary meaning usually depended on the parties being citizens of different states. Even this difference has largely disappeared through amendments to the 1905 statute.[3] Countries in Latin America and on the Continent of Europe give a much wider scope to trademarks than do our old technical rules. American manufacturers found that their geographical or personal tradenames, which could not be registered here under the 1905 statute, were suffering imitation abroad with impunity. Consequently, they induced Congress to amend the statute and permit increasingly wider registration, so that these tradenames should receive the foreign protection given by treaties to marks registered in this country. This also tended to produce a correspondingly wider domestic protection in the United States courts.[4] But some visible symbols of good-will cannot yet be registered, like the colors of taxicabs or the A. & P. shop-front.

2. SOCONY-VACUUM OIL COMPANY, INC.

DETERMINATION OF BRAND POLICY

In July, 1931, the Standard Oil Company of New York and the Vacuum Oil Company were merged to form the Socony-Vacuum Oil Company, Inc. Soon after the combination was effected, the

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[1] "Trademarks and Tradenames—An Analysis and Synthesis," 30 *Columbia Law Review*, 168, 759.

[2] 33 Stat. 725 (1905), 15 U.S.C. §85 (1934).

[3] 41 Stat. 533 (1920); 52 Stat. 639 (1938), 15 U.S.C. §§85, 121 (Supp. 1939).

[4] *Armstrong Paint & Varnish Works v. Nu-Enamel Corp.*, 305 U.S. 315 (1938), 52 *Harvard Law Review* (1939) 697.

executives of the new company reviewed the brand policy of the company in order to determine a program for the future. They decided to develop as soon as possible one national brand of first-grade motor oil based on the "Mobil" brand of products and to make a more gradual change to a national brand of gasoline.

The new company controlled a number of operating subsidiaries which distributed petroleum products. The Vacuum Oil Company sold "Mobiloil" lubricating oils throughout the United States and in many foreign countries. Most of the other operating subsidiaries of the Socony-Vacuum Oil Company, Inc., sold their products over a limited area in the United States. Among these subsidiaries were the Standard Oil Company of New York, which sold "Socony" gasoline and "Dewaxed" motor oils principally in New York and New England; the General Petroleum Corporation of California, which sold the "General" brand in California, Oregon, Washington, Arizona, Nevada, and Alaska; the Magnolia Petroleum Company, which sold the "Magnolia" brand in Texas, Arkansas, Oklahoma, and New Mexico; the White Eagle Oil Company, which sold the "White Eagle" brand in Kansas, Colorado, Missouri, Nebraska, Iowa, North Dakota, South Dakota, Wyoming, Minnesota, Wisconsin, and Montana; the Wadhams Oil Company, which sold "Wadhams 370" products in Wisconsin, Michigan, Minnesota, Iowa, and Illinois; the Lubrite Refining Corporation, which sold "Lubrite" products in Illinois, Indiana, Iowa, Missouri, and Ohio; and the White Star Refining Company, which sold "Staroline" products in Michigan, Ohio, and Indiana and in Ontario, Canada.

In considering what brand policy to pursue in the future, the executives of the Socony-Vacuum Oil Company, Inc., debated the possibility either of allowing the various subsidiaries to continue using their sectional brands or of developing one national brand for the entire organization based on the nationally known Mobil products. They decided to adopt the latter course because they wanted to advertise the products nationally and believed that the development of national brands would facilitate that action.

As the first step in carrying out this new policy, soon after the merger the company dropped all its brand names for first grades of motor oil except the Mobiloil brand and made this the premium brand of motor oil for its entire organization. This brand had been widely advertised for a number of years and was favorably

known throughout the United States and many foreign countries. The Socony-Vacuum Oil Company, Inc., planned to continue the aggressive promotion of this brand.

The company at this time decided not to standardize its second-grade brands of motor oil. In some cases it allowed subsidiaries to continue their own second-grade brands of oil and in others suggested that a new brand called "Lubrite" be introduced. The company did not plan to advertise any of the second-grade brands of oil.

The change to a national brand of gasoline, the company made more gradually; but by 1934 in nearly all its subsidiaries it was selling a new brand of gasoline called "Mobilgas" in the regular grade and "Mobilgas Ethyl" in the premium grade. The only regions in which it did not use these brands were New York and New England and the Wadhams Oil Company's territory. The Socony brand was so firmly entrenched in New York and New England that the company continued the Socony and Socony Ethyl brand names there but had the name "Mobilgas" also appear on the gasoline pumps. Wadhams Ethyl was sold along with Mobilgas in the Wadhams Oil Company's territory. When the company introduced Mobilgas, it started a national advertising campaign on the new brand throughout the entire United States.

The Socony-Vacuum Oil Company, Inc., sold a third grade of gasoline under the name "Metro" through a few of its subsidiaries. The company made no attempt to use this brand for third-grade gasoline throughout the country and did not advertise it.

Should the Socony-Vacuum Oil Company, Inc., have made any different decisions on brand policy?

3. JORDAN MARSH COMPANY

USE OF PRIVATE BRANDS BY A DEPARTMENT STORE

The Jordan Marsh Company, which operated the largest department store in Boston, Massachusetts, used a number of private brands[1] to promote the sale of selected items in its store. Blanket

[1] Manufacturers, producers, distributors, or associations may own brand names identifying commodities. "National brand" is used to designate a manufacturer's

brands included the names "Avona,"[1] "Super-Jordan," and "Latour." The Avona brand was used on merchandise appealing primarily to women; Avona goods were staple products, carried in stock throughout the year. Super-Jordan was confined to articles of men's apparel, sold in the store for men. Latour was applied to a few lines carried in the toilet goods department.

Excerpts from advertisements of these brands in 1934 and 1935 were as follows:

AVONA

1. ½ Price! Avona Pound Paper

Ripple parchment . . . large sheets! Glenwold linen in letter-size or large single sheets, as sketched. All white. Pound of paper and 50 matching envelopes. 29 cents
Linen or vellum in either letter-size or single sheets. All white. Pound of paper and 50 matching envelopes. 49 cents
Deckle-edged vellum. Pebble parchment! Varsity cloth in silver gray . . . large single sheets. Pound of paper and 50 matching envelopes. 79 cents

2. Our Avona Quality Birdseye Diapers
12 for $1

Usually $1.50! A dozen of these unusually fine quality diapers, hemmed, ready for use. The size: 20 × 40.

3. Avona Glove Silk Undies, 79 cents

Regularly $1.00! Our well-known brand in vests, bloomers, and flared or banded panties of glove silk with a thread of rayon for added strength! Blush color vests, sizes 36 to 42: blush color bloomers or panties, sizes 5 to 7.

4. Avona Hair Nets, 24 for 95 cents
Usually 12 for $1.00
Miss Avona Hair Nets, 12 for 75 cents
Usually 12 for $1.50

Both styles in cap shape—large or small sizes. Colors include gray, purple, and white.

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or producer's brand that has wide distribution, whereas "sectional brand" refers to a brand which is used over a rather wide area but not on a national scale. "Private brand" is used to designate a middleman's brand as distinguished from a manufacturer's or producer's brand. The loose usage in these three terms results in some confusion, and theoretically it would be preferable to use the terms "manufacturer's" or "producer's brand" and "distributor's" or "middleman's brand."

[1] "Avona" presumably was derived from the name of Avon Street, which bounded the Jordan Marsh store building on one side.

5. Repeating our noteworthy successes "Avona"!
Bien Jolie! Riteform!
Corsettes
Eleven models, regularly $7.50 to $10

Sizes from 34 to 46 according to the type of the garment! Styles for every figure—short, tall, heavy, medium, or slim! Quality that is standard with these famous makes—at higher prices! Altogether one of the most comprehensive FEATURE events we have ever managed at a SPECIAL price! Come in and examine the superior tailoring, finish—the advance Spring fashions!

6. Avona Dress Shields, 12 for $3.00
Regularly 12 for $4.00

7. 3,000 Finest Glove Silk Avona Underthings

Vests, Sizes 36–42 Reg. $2.50	$1.45
Bloomers, Habitees, Panties, 5–8 Reg. $3.50	$1.95

Extra Sizes 50 cents additional

Notice these points of quality! Double yokes and skilled reinforcements for wear! Full-cut and expertly tailored for fit! Soft, PURE glove silk for "Avona" quality! They're the day-in, day-out choice at regular prices of women who recognize the best—take advantage of this Birthday Sale saving! Pink or peach.

8. Avona Felt Filled Innerspring Mattresses $17.95
Regularly $26.50

There's restfulness in the soft, fluffy layers of clean white felt. It's a mattress that will keep its shape well because the innerspring unit is covered with a quilted felt pad that is stitched to a durable drill cloth. The 180 coils (full-bed size) are doubly tempered, giving them extra buoyancy. Blue-and-white A.C.A. ticking. All standard sizes.

9. Avona Sheets Specially Priced! $1.15
72 × 108 inches

Other Sheet Sizes:

90 × 108 inches	$1.35
81 × 108 inches	1.25
63 × 108 inches	1.00

Pillowcases

42 × 38½ inches	$.28
45 × 38½ inches	.30

Specially made, and exclusive with us in Boston! All sheets are torn 3 yards long and finished with 4-inch hem at both ends. Strong, heavy-weight sheeting assures long wear. It's an out-standing Birthday Sale Value!

SUPER-JORDAN

(Excerpts from four-page leaflet advertising this brand. The copy was bordered by illustrations and individual descriptions of topcoats, overcoats, tuxedos, suits, hats, and robes.)

JORDAN MARSH COMPANY
Store for Men

The SUPER-JORDAN WARDROBE expresses the sum of our experience in providing style, quality and value for well-dressed men.

Here is the history of a famous label. Some years ago we sat down to design a shirt—not because we needed more shirts, but because we wanted one that would express all our ideas and ideals of splendid shirthood—something worthy of our own name. From the fundamental raw material to the ultimate folded article we specified every creative step. Men acclaimed the result.

As from time to time we have added to the Super-Jordan wardrobe, until it has come to include everything from underwear to overcoats, from socks to hats, this acclamation has continued.

All our experience, all our knowledge of fine materials and sound tailoring, all the price advantages of our great purchasing power, are summed up in the Super-Jordan label. Dollar-for-dollar, we know of no better values.

Super-Jordan PRICES

Super-Jordan prices have always been a secondary consideration. We have never set a price and then shopped around to see what we could get for it. We have invariably set our standard of material and workmanship first and only then worked out the price.

These prices we have kept as low as possible—much lower than one would expect elsewhere for the same quality—which explains why they have varied in the past few years, why they may well be higher in the near future, and why, whatever the price, there will never be doubt of the quality behind the label.

Super-Jordan MATERIALS

"Original fabrics at less than cost of most imitations," has always been the Super-Jordan motto. We have never failed to live up to it. Our buyers ransack the world for the materials men want. They exert their tremendous purchasing power at the source of these materials. There is never any picking up, here and there, piecemeal, at the mercy of secondary markets.

Therefore, when we speak of hand-loomed Harris tweed, we mean hand-loomed Harris tweed, loomed by hand on the Isle of Lewis and

Harris—not just something approximating hand-loomed Harris tweed. The same applies to every kind of materials used in every kind of Super-Jordan garment. All are genuine or they would not bear the Super-Jordan label.

Super-Jordan TAILORING

Super-Jordan tailoring is based on our belief that no garment, regardless of the material in it, is fit to be worn unless it looks as fit after months of wear as on the first day of service. Therefore Super-Jordan suits are permanently shaped from the beginning by countless skillful hands—not pulled or pressed into shape at the last minute by machinery. Only thousands of well-considered stitches—each one thought out and executed with skill—can turn a flat piece of cloth into a graceful garment. This painstaking care extends not only to the cloth that everyone sees, but to the linings that few see, and the underbodies that no one sees at all. Like buildings and reputations, Super-Jordan clothes are built from the underground up.

Items appearing in advertisements under the Super-Jordan name included the following:

1. Super-Jordan Shirts........................	$ 3.50
2. Super-Jordan Neckties.....................	1.00
3. Super-Jordan Shorts........................	1.50
4. Super-Jordan Silk Hose.....................	1.00
5. Super-Jordan "Topper" Suits..............	3.95
6. Super-Jordan Suits and Topcoats...........	35.00

LATOUR

1. Latour Professional Size Cleansing Tissues........... 3 for $1.19
   Regularly 59 cents each

2. Latour Bath Soap, 12 cakes............................ $1.10
   Regularly $2.00

3. Latour Toilet Water, full 4-oz. size...................... $.89
   Regularly $1.00

In addition to its blanket brands, the Jordan Marsh Company used individual brands for a number of items, as illustrated by the following excerpts from advertisements:

1. Jordan-Arch Shoes Goodyear Welt Stitched............... $4.95

2. Repeating Our Values in Children's and Misses' Olde Brick Shoes, 25% off!

3. Our Regular $2.50 Jordan-Bilt Shirts, Sale Priced at........ $1.75
Sizes 13½ to 18
Sleeves 32 to 36

For high-quality broadcloth, high-quality design, and high-quality workmanship, Jordan-Bilt shirts are exceptional even at their regular price.
They're the finest-count shirts we've sold at this price.
Each shirt hand pressed and hand cut by an expert shirtmaker.
Each shirt cut full—can't bind or ride up.
Extra strong thread minimizes tearing at seams.
Collars scientifically designed to look and stay smart.
Neckband style in white.
Collar-attached style in white.

4. Own Famous Nova Sheets, size 63 × 99 (torn sizes)..... 89 cents
Regularly $1.10
Reductions on Other Sizes:

Size	Regularly	Now
63 × 108 sheets	$1.15	$ .95
72 × 99 sheets	1.15	.95
81 × 99 sheets	1.25	1.00
81 × 108 sheets	1.35	1.15
90 × 108 sheets	1.50	1.25
42 × 38½ cases	.30	.25
45 × 38½ cases	.35	.30

5. The new Jordan Marsh Company innerspring mattress that scored an immediate "hit" when we introduced it. Based on years of experience in design!
"BETTER SLEEP" Red Label Imperial Edge Felt Top $19.75
Regularly $29.50!

"BETTER SLEEP" because it has 182-coil (full-bed size) super-edge unit of springy, finely tempered coils with hinged-action double-offset construction. A compressed and quilted sisal-fiber pad cushions the coils. Over this is 40 pounds (full-bed size) of long, staple, pure white felt. Handmade throughout and covered with 8-oz. blue-and-white ticking. Four rows of stitching and a mercerized cord trimming reinforce the sides. Imperial edge. All standard sizes. Matching box spring, $19.75.

Handmade BETTER SLEEP Red Label
Made Exclusively
for
JORDAN MARSH COMPANY

The Jordan Marsh label appeared also on a number of household remedies and medicine-chest staples, as illustrated by the following:

1. Extra-Large Economy Sizes in Jordan Marsh Remedies:

Russian Oil, ½ gallon		$1.09
Witch Hazel, ½ gallon		.69
Milk of Magnesia, ½ gallon		.79
Mouth Wash and Antiseptic, ½ gallon		.74

2. Jordan Bath Soap .... .59
   12 cakes regularly 69 cents a box

3. Savings on Jordan Marsh Company's own Laboratory Tested Requisites:

Aspirin, bottle of 200		$.49
Antiseptic Mouth Wash, red or amber, 32 oz.		.43
Boric Acid Powder, 1-lb., regularly 29 cents		19
Epsom Salts, 5 pounds, regularly 39 cents		.32
Bay Rum, 16-oz. size		.39
Milk of Magnesia, quart size		.43
Seidlitz Powders, 12's	2 boxes for	.29
Witch Hazel, 16-oz. bottle		.25
Russian Oil, 32-oz. bottle		.65
Rubbing Alcohol, regularly 19 cents	4 bottles for	.59
Wintergreen and Alcohol Rub, 16 oz.		.29
1 lb. Absorbent Cotton	3 for	.89
Professional Shampoo, blonde, coconut oil, castile, olive oil		.39
Germicide, 8-oz. size (spray 35 cents extra)		.45
Lilac Vegetal, 8 oz.		.49
Milk of Magnesia Toothpaste	4 large tubes for	.55
Toothbrushes, tufted or oval type, regularly 25 cents	4 for	.69

Of what significance were the Jordan Marsh Company's private brands to its customers? What changes, if any, should the company have made in its use of private brands? Should it have increased or decreased the number? Should it have used only a few private brands closely associated with the company name? For what types of merchandise should it have used private brands? Should it have applied private brands primarily to types of merchandise customarily branded by manufacturers, or to types of merchandise commonly not branded by manufacturers?

4. MANSION STORES COMPANY

USE OF PRIVATE BRANDS BY A GROCERY CHAIN

The Mansion Stores Company operated a chain of more than 500 retail grocery stores. In July, 1935, a salesman of the Motone Company suggested that the Mansion Stores Company stock a prepared pancake flour under the company's private brand, "Mansion." The Mansion company's buyer agreed to consider the proposal.

The Mansion brand was used on between 80 and 90 of the 1,200 items which the company carried in stock. A few products were sold under other private-brand names, but the latter were unimportant in comparison with the Mansion brand. All Mansion-brand products were expected to duplicate the best quality of competing nationally advertised brands.

In the company's newspaper and handbill advertising Mansion-brand and nationally advertised products were featured concurrently. The company's store managers were instructed to be cautious in attempting to substitute the Mansion brand for nationally advertised brands. When a customer specified a nationally advertised brand, the salesclerk was not allowed to suggest the Mansion brand unless he was well acquainted with the customer. If a customer asked for a product without specifying the brand, the salesperson was to place one hand on a package bearing the Mansion brand and at the same time to inquire what brand was preferred.

In studying the proposal to add Mansion pancake flour to the company's line of products, the buyer found several points in favor of the purchase. The product offered by the Motone Company was equal to that of the leading nationally advertised brand, the only brand of pancake flour stocked by the Mansion Stores Company. The Motone Company sold pancake flour under both its own advertised brand and distributors' brands, but its advertised brand was not carried in stock by the Mansion Stores Company. The salesman offered the pancake flour to be labeled "Mansion" for 70 cents a case of 12 standard packages; thus the buyer could afford to sell it at retail for 9 cents or 10 cents a package. The leading advertised brand, of which the company sold about 5,000 cases a year, was purchased at $1.08 a case and sold at retail for 12 cents a standard package. If the buyer decided to accept the

EXHIBIT 1

MANSION STORES COMPANY

Comparative Cost and Retail Prices and Volume of Sales in 1934 of Selected Products Carrying Nationally Advertised and Private Brands

Product	Brand	Cost	Retail	Annual Volume
Coffee (Unit: pound)	Nationally Advertised A	$0.25½	$0.28	350,000 lb. (80% on brands A and B)
	Nationally Advertised B	0.23	0.25	
	Nationally Advertised C	0.23	0.28	
	Nationally Advertised D	0.20	0.25	
	Mansion	0.16	0.23	1,000,000 lb. (50% on Mansion)
	Aroma*	0.13	0.19	
	Primo*	0.12	0.17	
Tomato Soup (Unit: case of 48 standard cans)	Nationally Advertised	$2.94	$3.36	15,000 cases
	Mansion	1.80	2.40	6,000
Wheat Cereal (Unit: case of 12 28-oz. packages)	Nationally Advertised	$2.16	$2.76	6,000 cases
	Mansion	1.40	2.28	4,000
Mayonnaise (Unit: case of 12 jars)	Nationally Advertised A:			
	½ pt.	$1.56	$2.04	20%
	1 pt.	2.75	3.48	
	1 qt.	4.55	5.64	
	Nationally Advertised B:			
	½ pt.	1.56	2.04	
	1 pt.	2.75	3.48	
	1 qt.	4.55	5.64	
	Mansion:			
	½ pt.	1.14	1.80	80
	1 pt.	2.00	3.00	
	1 qt.	3.50	5.16	
Baking Soda (Unit: case of 12 1-lb. packages)	Nationally Advertised	$0.64	$0.96	75%
	Mansion	0.42½	0.84	25
Mustard (Unit: case of 12 9-oz. jars)	Nationally Advertised A	$1.10	$1.44	25%
	Nationally Advertised B	1.10	1.56	25
	Mansion	0.72	1.08	50
Rolled Oats (Unit: case of 18 20-oz. packages)	Nationally Advertised	$1.35	$1.62	89%
	Mansion	1.15	1.62	11
Tomato Ketchup (Unit: case of 12 standard bottles)	Nationally Advertised	$1.90	$2.28	10%
	Mansion	1.20	1.80	90

* Private brand of the Mansion Stores Company.

salesman's offer, the Mansion brand of pancake flour would yield a larger gross margin than the advertised brand in stock, even though the retail price on the Mansion brand would be lower.

Two other possible sources of private-brand pancake flour were approached by the buyer while he was trying to come to a decision, but their terms were found to be less favorable than those of the Motone Company. One company quoted a price of 66 cents a case but insisted upon carload orders (1,200 cases). The other company quoted a price of 75 cents a case. The Motone Company, on the other hand, did not require any volume commitments but did ask customers to purchase unused labels at cost in the event that the line was discontinued. Neither of the other sources, in the opinion of the buyer, was so reliable as the Motone Company.

As a check on the volume possibilities of a Mansion-brand pancake flour, the buyer reviewed the 1934 experience of his company with representative items carrying the Mansion brand. He knew that, in several instances, addition of the Mansion brand had been followed by a 10% to 20% increase in the sales volume of the particular product and that in each of these cases sales of the Mansion brand more than accounted for the increase in volume. The Mansion-brand items which the buyer selected as representative of results for the year 1934 were as shown in Exhibit 1.

Should the Mansion Stores Company have accepted the proposal of the Motone Company for the sale of pancake flour under a private brand?

5. TRADING UP AND TRADING DOWN

USE OF THE SAME OR CLOSELY SIMILAR BRAND NAMES ON DIFFERENT GRADES OF THE SAME PRODUCT

A. BADGER WATCH COMPANY

In 1910 the Badger Watch Company bought the plant and assets of the Lincoln Watch Company, which was in receivership. Up to that time the Badger Watch Company had produced watches which retailed at $1 each. They were advertised extensively, and were sold in retail jewelry stores and other stores in nearly every city and town in the United States.

After the purchase of the Lincoln Watch Company the Badger Watch Company introduced a new line of watches to retail in nickel cases at $5 each and in gold-filled cases at $7 to $15. This product was sold under the "Badger-Lincoln" brand directly to retailers by the Badger Watch Company's salesmen. The addition of the new line was expected to reduce substantially the ratio of salesmen's traveling expenses to sales. The Lincoln plant was well equipped for production of Badger-Lincoln watches.

The company allotted most of the advertising appropriation for a period of several years to the Badger-Lincoln brand in order to place the new watches effectively before the public. Meanwhile the prestige and sales momentum already attained for Badger watches were expected to carry that line. During the four years after the purchase $520,000 was spent to advertise Badger-Lincoln watches. In the first year, although the Badger Watch Company did not make a profit from the new line, it secured a satisfactory volume of sales. Nine thousand retailers purchased stocks of Badger-Lincoln watches. As anticipated, the average size of the orders was small. During the second year the volume of sales increased substantially, but the orders were obtained chiefly from new customers. In the third year the sales of Badger-Lincoln watches increased slightly, but the volume of repeat orders was still small. Out of 18,000 retailers who had purchased the Badger-Lincoln line during the first three years, only 7,000 had reordered and only 4,000 had placed as large repeat orders as had been expected. Because in earlier years the word "Badger" had been associated closely with less expensive watches, the new line was advertised during the fourth year merely as the Lincoln watch; nevertheless, sales declined slightly. Although during these four years the Badger watch was not advertised extensively and was not given more than normal selling effort, sales of Badger watches increased 31% the first year, 34% the second year, and 23% the third year, and continued to increase during the fourth year.

B. WILDA BISCUIT COMPANY

In 1912 the salesmen of the Wilda Biscuit Company requested that the company manufacture an additional line of biscuits, of lower grade and price than the Wilda brand. The salesmen stated that, despite the competition of other producers, an increase in the volume of sales could be secured if distribution was obtained in

retail stores which previously had been unable to sell the company's biscuits because of their high price.

The Wilda Biscuit Company manufactured high-quality packaged biscuits and crackers in 140 varieties, which it sold exclusively to retail grocers. It advertised extensively in the six-state area in which it operated; the company was well established and had gained a favorable reputation for the quality of its products. The biscuits were shipped to retailers immediately after manufacture; none were held in storage awaiting orders. The company employed, on a commission basis, 150 salesmen, who called on retail grocers in the districts which it served.

An advantage of making the new line was that machinery could be utilized more completely. In the manufacture of biscuits, after the dough was mixed it was transferred to a machine performing three operations: panning, peeling, and cutting. At the end of the operations in this machine the biscuits were ready for the oven. Each panning, peeling, and cutting machine was so placed that it supplied an oven. Frequently a series of machines were idle; and, because of their size, the idle-time charges on them were heavy. The manufacture of a cheaper line of biscuits seemed justifiable if the sales permitted the company to eliminate idle-machinery charges. No storing or purchasing difficulties were involved; the labor force was adequate and competent to produce the additional line.

The company consequently decided to make, under a different brand, 18 new varieties of biscuits. These were not to be packaged but were to be shipped in cases. Because of this economy and the use of cheaper materials, the new brand could be sold at prices 20% lower than those of the Wilda variety. Salesmen were instructed not to solicit orders for the new biscuits from the established customers of the company but to use the new line to obtain orders from stores to which the company formerly had been unable to sell. The rate of salesmen's commission on the new line was slightly lower than that on the old line.

Records were kept of the sales of the two lines. Eighteen months after the lower quality of biscuits had been placed on the market, the sales of that grade showed a steady and substantial increase, whereas the sales of the Wilda brand had declined. From investigation the company learned that the lower quality of product was displacing the original brand, because salesmen, contrary to

instructions, were using the appeal of low price to obtain orders from customers who formerly had bought the higher quality of products. The company decided, therefore, to discontinue the manufacture of the lower quality of product and to concentrate on the development of the Wilda brand.

How were the results of the experience in these two cases to be explained?

How should "trading up" and "trading down" be defined?

What policies should be formulated with respect to trading up and trading down?

6. DRIVER-HARRIS COMPANY

BRAND POLICY ON ELECTRICAL-RESISTANCE ALLOYS

In 1925 the Driver-Harris Company, of Harrison, New Jersey, purchased a smaller competing company manufacturing lines practically identical with its own. This purchase gave rise to a brand problem.

The Driver-Harris Company, with annual sales of several million dollars, manufactured wires for electrical resistance; wires for mechanical, chemical, and other uses; alloys for special purposes in rods, strips, or sheets; cord for electrical heating devices; castings for use when high resistance to heat was required; dies for drawing wire; and pure nickel. Nickel was the basic substance in Driver-Harris products. The most important line was the electrical-resistance wires. These wires were sold chiefly to manufacturers of electric heating devices, such as toasters, curling irons, electric stoves, and, in the industrial field, electric furnaces. An officer of the company estimated that there were 3,000 to 4,000 purchasers of electrical-resistance wires, but that 35 of them accounted for 80% of the total purchases of such wires. Except on the Pacific Coast, the company sold direct to users.

The Driver-Harris Company was a large advertiser, both in trade papers and direct by mail. In its advertising it stressed the fact that by buying from the Driver-Harris Company users could be confident of quality and uniformity of product.

For more than 15 years before 1925 the Driver-Harris Company had been selling an electrical-resistance alloy, in the form of wire, ribbon, strip, rods, sheets, and castings, under the registered trade-mark "Nichrome." This alloy, which was made of nickel and chromium, had proved highly satisfactory in use. It was possible to test the metal before buying but not the part that was to be used, for the tests that were applied completely destroyed the part tested. Consequently, the user had to rely for uniformity upon the integrity of the supplier. The value of the resistance wire in an electrical heating device was relatively small, but the performance of the wire itself under operating conditions was of great importance. It was estimated that the cost of the wire in an electric toaster or an electric flatiron was 6 cents to 10 cents. In an electric industrial furnace selling for $4,000, the wire might cost $500 to $600. With the exception of one competing product, which was sold at the same prices as Nichrome, alloys comparable to Nichrome were sold, it was stated, for 10% less than that alloy. Compared with nonalloy wires, Nichrome was high in price. Comparable prices for one size, for example, were 12 cents a pound for steel wire, 26 cents for bronze, 91 cents for nickel, and $2.52 for Nichrome.

In addition to Nichrome, the Driver-Harris Company had developed three other grades of nickel-chromium alloy. These it called Nichrome II, Nichrome III, and Nichrome IV. The company also had several other types of alloys that it sold under distinctive trade names. "Comet," for example, was the name applied to a nickel-chromium-iron alloy; and "Advance" was the name given nickel-copper alloy. These names were registered and protected by the company, but their significance was not so widely and generally accepted by users as was that of Nichrome, nor was their sales volume comparable to that of Nichrome.

Nichrome II and Nichrome III were of little importance and, in fact, had been practically discontinued. Nichrome IV, however, was designed to fill a specific need. Although that alloy was based on Nichrome I and was meant for the same type of uses, it was supposed to be of a better grade and to be able to resist much higher temperatures. Nichrome IV, in other words, was intended for use in heavy-duty heating apparatus operating at high temperatures for long periods, whereas Nichrome I was

for use in a lighter type of heating apparatus. Nichrome IV was about 50% higher in price than Nichrome I.

The Driver-Harris Company had been selling Nichrome IV for four or five years when it purchased the competitive company. Nichrome IV, however, had not been thoroughly successful, chiefly because it lacked uniformity. At the outset it sold readily because of the proved excellence of Nichrome. Many companies, after using Nichrome IV for a short time, however, ceased to use it, and sales were failing to show any increase.

The competitor which the Driver-Harris Company purchased in 1925 had been marketing for several years a nickel-chromium alloy directly comparable to Nichrome IV. This alloy was sold under the trade-mark "Karma." Other alloys made by this competitor were of good quality, but for the most part they were inferior to Driver-Harris products. Karma, on the other hand, was superior to Nichrome IV, and its sales had been increasing constantly. Total sales of the manufacturer of Karma amounted roughly to half a million dollars. Of that amount, about 30% represented sales of Karma. Sales of Karma were larger than sales of Nichrome IV.

After the Driver-Harris Company purchased the competing firm, it was in a position to continue the manufacture of Karma and to discontinue the manufacture of Nichrome IV. The question raised was whether the company should call the product Karma or Nichrome IV. Karma had been advertised in trade papers and directly to users. It was an excellent product and had proved thoroughly satisfactory in use. In its performance it was comparable to Nichrome I. The name Karma was thought to have a pleasing sound and to be capable of lending itself to effective advertising. Nichrome, on the other hand, was an outstanding name for electrical-resistance alloys. It was far better known than Karma. Nichrome IV, however, had proved unsatisfactory.

What brand policy should the Driver-Harris Company have followed?

Was the reasoning with respect to trading up and trading down applicable to this situation?

7. WESTER COMPANY

BRAND POLICY IN WARTIME

The severe restrictions imposed on the use of rubber in early 1942 forced the Wester Company, a manufacturer of rubber footwear, to resort to the use of reclaimed rubber compounded with a substitute material and mixed with only a minimum proportion of crude rubber. In placing on the market the rubber footwear thus manufactured, the Wester Company debated whether to use its regular brand name or to develop either a variation of this brand or a wholly new brand.

The Wester Company, established in 1870, was one of the largest manufacturers of high-quality canvas and rubber footwear in the country. Its total sales volume in 1941 was approximately \$50,000,000, nearly the highest figure which the company ever had attained. Although the sales of rubber footwear were notably affected by weather conditions and although the fall and winter of 1941 were mild seasons, nevertheless the desire of retailers to build up stocks in anticipation of the increased purchasing power and needs of final consumers boosted the sales volume to an unexpectedly high figure.

The Wester Company's channels of distribution comprised four general classes of customers. Group 1 consisted of buyers of large quantities, such as large chain store companies, mail-order houses, and wholesalers. There were about 25 customers in this group, all of whom performed the wholesaling function of purchasing large quantities of footwear on advance orders, storing the merchandise, and distributing it to retail outlets in small lots. Sales to this group, amounting to about 30% of total volume, were made direct from the factory. Group 2 was made up of regional chain store organizations competing in limited areas with the national chains. These companies also performed the wholesaling function, and shipments to them likewise were made direct from the factory. In Group 3 were department stores, small chains, and large independent retail shoe stores. Group 4 was made up entirely of small independent retail stores. For the retail customers in Groups 3 and 4 the Wester Company performed the wholesaling task through the branches which it maintained in the principal cities of the United States. Although the orders placed by Group 3 customers

were characteristically somewhat larger than those obtained from the smaller retailers in Group 4, the type of service required and the costs of selling were not greatly different.

It was the policy of the Wester Company to sell rubber footwear under the Wester brand to customers in Groups 2, 3, and 4. Goods of the same quality, though commonly different in appearance, were sold to a majority of the customers in Group 1 under private brands. The Wester Company's brand name had been made well known in the rubber footwear trade through the company's extensive advertising campaigns. The Wester brand was widely accepted as carrying the assurance of high quality, and the company considered the reputation of the brand to be one of its most valuable assets.

Up to the middle of 1941, the Wester Company was producing over 1,000 different items of canvas and rubber footwear for men, women, and children. In the rubber footwear division alone there were 420 different styles, most of which were offered in a choice of four colors, red, white, brown, and black. The output of the various style numbers was determined by the orders received. Each year from February until July the salesforce solicited orders from the company's accounts for the following fall and winter seasons. Operations of the production division were closely geared to the trends noted in the orders received. In other words, the company pursued a policy of making what it could sell; its manufacturing operations were guided by market considerations.

Beginning on July 1, 1941, successive modifications in this policy became necessary. On that date the Federal government assumed control of the use of crude rubber in order that it might begin to build up a stock pile. The footwear section of the rubber industry was placed on a sliding scale which permitted the use in July of 99% of the average monthly consumption for the base period and thereafter moved downward each month to a figure of 80% for December, 1941. Immediately after the outbreak of war with Japan on December 7, the government froze the monthly consumption of crude rubber by the footwear industry to the November figure. As the situation became steadily more serious, further restrictions were enforced. On February 1, 1942, the monthly use of crude rubber in rubber footwear was reduced to 40%, and in canvas footwear to 30%, of the average monthly consumption during the base period. On March 1 the use of

crude rubber in canvas footwear was eliminated, and its use in rubber footwear was further curtailed.

The government permitted the production of rubber footwear to continue because the use of such articles was recognized to be essential to the maintenance of production in many factories, mines, oil fields, commercial fisheries, meat packing establishments, and so on. Also, rubber footwear was recognized as important for the preservation of the health of civilians.

These various restrictions on the use of crude rubber necessitated a change by the Wester Company from a policy of governing production by market requirements to a policy of governing production in accordance with restrictions on the use of raw material. In July, 1941, the executives established four yardsticks as aids to their judgment. These yardsticks were as follows: (1) number of pairs per pound of rubber, (2) dollars of sales per pound of rubber, (3) dollars of net profit per pound of rubber, and (4) economic and social utility of each item in relation to the defense effort. The first yardstick protected the interests of both employees and customers. The second and third yardsticks protected the interests of the company and its stockholders. The fourth yardstick took into account the objectives of the national policy in the prosecution of the defense effort.

With these yardsticks as a guide, the executives reduced the Wester line of rubber footwear from 420 styles to 62 styles and eliminated the white and red colors. Even with this reduction in the number of styles, however, the potential output in number of pairs on the basis of the supplies of crude rubber available to the company was still too small. The executives turned, therefore, to the research division, which had been experimenting for many years on the use of reclaimed rubber. Because of the work that had already been done, the research division was able to provide promptly a compound of crude and reclaimed rubber from which high-quality rubber footwear could be produced. The footwear manufactured from this compound met all the standards established for goods manufactured with the free use of crude rubber, and therefore the company had no hesitation in marketing this product under the Wester brand. Through the use of this compound of crude and reclaimed rubber the company was able to maintain its volume of production at a high level throughout the remainder of 1941.

In the early part of 1942, in addition to imposing the further restrictions previously described on the use of crude rubber, the government also set limits to the quantity of reclaimed rubber that could be used in the manufacture of rubber footwear. At the same time, the range of colors was restricted to one, namely, black. Consequently the Wester Company faced the possibility of a drastic decline in its output. Fortunately, however, the research division, having anticipated the possibility of these further restrictions, had developed a substitute material to be mixed with reclaimed rubber and a small proportion of crude rubber. From this compound, rubber footwear could be produced which was serviceable though definitely inferior in qualities other than workmanship. It was thought that, if the buying public was warned of these inferiorities and was instructed in the proper care of the new product, the goods would afford reasonable wear and protection. Therefore the management decided to market as its sole line of rubber footwear the products made from the compound that had been developed.

Naturally this decision posed a problem of the brand to be used on this new line of footwear. The company's trade-mark was the Wester name appearing on an oval background. It had been customary to imprint this trade-mark on all the company's first-quality footwear products, with the exception of the goods sold under private brands and likewise with the exception of seconds, which had been sold unbranded. The trade-mark also had been featured extensively in the company's advertising. After considerable discussion among the executives, the principal alternative courses of action appeared to be the following:

1. The new line of rubber footwear might continue to carry the company's regular brand as in the past. In the advertising copy the public would be told of the change in ingredients and warned of the additional care necessary to derive satisfactory service from the product. At the same time, a printed slip inserted in each box of footwear would convey similar admonitions. The chief argument in favor of this course of action was that the Wester Company's product, with the altered conditions of manufacture affecting all makers of rubber footwear, would continue to be fully as good as, if not superior to, all other products of its type. The regular use of the brand also would have the advantage of affording continuity to the company's promotional program.

2. A second possibility was to discontinue imprinting a brand name on the footwear, with a view to preventing the Wester reputation from being injured by possible failure of the wartime product to give full satisfaction to consumers. If this plan were adopted, presumably a printed slip would be included in each box of footwear, reading approximately as follows:

"VICTORY" QUALITY

WESTER COMPANY

To help conserve rubber, a minimum quantity of crude rubber is used in this product.

Except for workmanship, usual guarantees do not apply.

To get maximum wear—
1—Wash rubber surface to remove dirt, fats, oils, or acids after use.
2—Dry out linings under normal temperature before putting away.
3—Store in cool, dry place away from direct light.

After the duration, this trade-mark

WESTER

will again be the Sign of
Extra Quality and Outstanding Features.

With respect to advertising, several different programs might be followed: (*a*) Advertising copy might be developed along the lines of the proposed enclosure; (*b*) advertising might be used to keep the Wester brand name before the public, but the copy itself might be devoted not to the wartime line of footwear but to the proper care of the old-quality Wester goods still in the hands of consumers, to the notable achievements of the Wester Company on the war work which was employing nearly half the company's plant capacity, or to the experimental work of the Wester research division in the development of new products to be marketed after the war; or (*c*) advertising space outlays might be greatly reduced and the resulting savings used to augment reserves to help the company meet the difficulties of the postwar transition period.

3. A wholly new brand name might be developed for the wartime product, clearly distinguished from the Wester brand. Only the

new name would appear on the product itself, but in the advertising the new brand would be linked with the name of the Wester Company in such a way as to indicate clearly the secondary quality of the new line.

What action should the Wester Company have taken?

VII

SALES PROMOTION

A. CHOICE OF METHODS

1. DETERMINATION OF PROMOTIONAL STRATEGY

What should be the general strategy of the sales promotional program for each of the following companies, including decisions as to the relative emphasis to be given to personal selling, consumer advertising, and trade advertising, and also decisions regarding the forms of consumer advertising to be used? In reaching conclusions, consideration should be given to the characteristics of the products, the buying habits and buying motives of consumers, and the probable size of the promotional funds.

A. KATCHES

In 1928 a Boston inventor perfected an improved device called "Katches" for attaching license plates to automobiles. Katches simplified the task of attaching license plates to automobiles, because the device was in one piece and thus did away with the necessity for bolts and nuts and lock washers. Furthermore, Katches would not rust and could always be attached or removed by one turn of a screw driver. This new invention cost 3 cents a pair to manufacture. The inventor expected to sell them to the retail trade for 6 cents a pair and suggested that the latter resell them for 10 cents a pair. Since most license plates were changed during the first three months of the year, he expected that the sales of this product would be highly seasonal.

B. SUCROSA SUGAR COMPANY

The Sucrosa Sugar Company was a large eastern refiner of cane sugar. One-third of its product was sold to industrial users such as confectioners, while the other two-thirds was sold to wholesalers and chain stores for domestic consumption. Domestic sales of sugar were divided between sugar sold in bulk and packaged sugar. A differential of 60 cents a hundred pounds to cover additional

overhead cost and direct cost of packaging was charged for the packaged sugar. Gross profit on the sale of sugar was very small, and competition was intense. The company's experience had shown that consumers were ordinarily unwilling to pay more than ½ cent a pound extra for sugar in packages. The company realized that its sugar was for the most part indistinguishable in quality and taste from that of its competitors.

C. TRABANTA COMPANY

The Trabanta Company manufactured the Trabanta Remedy, a household medicine and tonic for nervous complaints and general "run-down" conditions. The company sold 50% of its product to wholesalers and 50% to chain stores, independent retailers, and those users who ordered direct from the factory. The company's selling price was 83.3 cents a bottle; manufacturing cost and factory overhead amounted to 25 cents. The retail price ranged from 98 cents to $1.25 a bottle, and distribution through drug stores was thought to be very wide.

D. OWL-FIBER RUG COMPANY

The Owl-Fiber Rug Company manufactured rugs made of spun paper yarn and wool and cotton yarn, for sale to department stores and wholesalers. These rugs were made in a number of attractive patterns and gave very satisfactory service in actual use. They were mainly sold to small-home owners for inside all-year-round use. Rugs manufactured by this company competed not only with all-wool rugs and oiled-surface floor coverings such as Congoleum, which were more expensive than fiber rugs, but also with other wants of users, such as furniture and electrical appliances. The manufacturers of oiled-surface coverings had advertised their products very extensively, one company having spent more than $1,000,000 in a five-year period. The Owl-Fiber Rug Company, on the other hand, had done little advertising.

E. CLAYBON COMPANY

The Claybon Company was one of four large manufacturers of cheesecloth. Cheesecloth was mainly used for polishing, dusting, and straining, for surgical work, and for curtains and nettings. There were 13 principal grades of cheesecloth, the retail prices of which varied, when sold as piece goods, from 7 cents a yard for the coarser grades to 20 cents a yard for the finer grades. In addition

to what was sold as piece goods a considerable quantity of cheesecloth was sold in packages. Packaged cheesecloth was available in five standard grades in 5- and 10-yard lengths. To cover the extra costs of packaging, manufacturers charged 1 cent a yard more for packaged cheesecloth than for roll cheesecloth.

F. DEFIANCE STOVE COMPANY

The Defiance Stove Company manufactured stoves, ranges, and furnaces. The company sold a large number of different styles and models under private brands to hardware stores and retail furniture dealers. The market for its products was largely confined to the five states closest to the company's plant, because the bulk of the articles made prohibitive the expense of shipping them any great distance. Most sales of stoves to consumers were made in one season of the year. The company's sales amounted to $500,000 annually.

G. LUKAN MILLS

Lukan Mills was a large manufacturer of cotton goods, including bleached goods, draperies, percales, flannels, wash goods, sheetings, and shirtings. Products were sold to consumers either by the yard in retail stores or in the form of ready-made garments, such as shirts, nightwear, underwear, dresses, smocks, and kimonos. The only products which were completely finished by Lukan Mills for consumer use were sheets, curtains, and a few specialties such as shoe bags and table covers. By far the largest part of the company's output went to cutters (that is, garment manufacturers). The total annual sales volume of the company was approximately $33,000,000.

H. FAFNIR BEARING COMPANY

Before 1923 the Fafnir Bearing Company, a large manufacturer of high-grade ball bearings, had concentrated its sales efforts primarily on the automobile industry, since that was practically the only large industry in which there was no sales resistance to ball bearings. In 1923, 65% of the company's sales were made to automobile manufacturers. Because of the concentration of its sales in this one market, the company, during the depression of 1920 and 1921, had been obliged to shut down its factory. From this experience it was evident to the executives of the company that diversification of markets was desirable.

It was thought that there were large potentialities for the development of sales of bearings to manufacturers of machine tools, textile machinery, and blower systems. Plain bearings were being used in blowers, for example; but through inquiries the company learned that most users of blower systems experienced difficulty with burnt-out bearings. Salesmen of the Fafnir Bearing Company visited manufacturers in these three industries and attempted to convince them of the advantages which would result from the use of ball bearings in their products. Initially, however, these manufacturers were unwilling to increase their costs by using the more expensive type of bearing.

I. BUCKNER TEXTILE MACHINERY COMPANY

The Buckner Textile Machinery Company manufactured all types of machinery used in the various steps of cotton manufacturing up to the stage where the cotton yarn went to the looms. Of the 1,200 cotton textile mills in the United States, about half were customers of the Buckner company. This company manufactured approximately 40% of the cotton-preparing and cotton-spinning machinery sold in the United States. Its largest competitor also produced about 40%, and three smaller organizations supplied the remainder. The average size of orders for Buckner machines was about $35,000.

2. BENSON COMPANY

RELATIVE IMPORTANCE OF ADVERTISING AND DEALER PROMOTION

In 1933 the Benson Company decided to sell its products in small sizes to variety chains. The company produced soap and other toilet articles which were said to possess medicinal properties for preventing and overcoming skin irritations. The officials of the company believed that distribution in variety chains would provide an excellent form of sampling at the consumer's expense. Large numbers of people were expected to see the products on display in the variety stores, and they were expected to buy because of the maker's well-established reputation and the low price. If the first trial was satisfactory, then the executives believed that consumers

would buy the normal size, or 25-cent package, at convenient drug stores.

Products of the Benson Company were sold to over 4,000 customers, primarily drug wholesalers and drug retailers. Orders amounting to $50 or more were accepted by the Benson Company direct from any chain store organization, wholesaler, or retailer whose credit was satisfactory.

All distributors and dealers who were able to purchase Benson products direct from the manufacturer paid $25 a gross for the 25-cent items. The company suggested that wholesalers sell the 25-cent items to retailers for $2.30 a dozen, but the wholesalers typically charged $2.40 a dozen. The margins yielded distributors and dealers by these prices were as shown in Exhibit 1.

Exhibit 1
Benson Company
Price Schedules

Class of Business	Unit Selling Price	Unit Cost	Markup
Retailers:			
Buying from Manufacturer (2 gross minimum)	25.00¢	17.36¢	30.56%
Buying from Wholesaler (suggested)	25.00	19.17	23.32
Buying from Wholesaler (typical)	25.00	20.00	20.00
Wholesalers:			
Suggested	19.17	17.36	9.44
Typical	20.00	17.36	13.20
Variety Chains:			
Under 5 Gross	10.00	6.95	30.50
5 Gross or More	10.00	6.25	37.50

No salesmen were employed to sell Benson products; the company relied entirely on consumer advertising to obtain and hold distributors. Its annual advertising appropriation, spent largely for newspaper advertising, averaged 30% of net sales. Spot checks made from time to time indicated that retailers seldom displayed Benson soap but kept it under the counter. They sold it only when consumers requested it. In spite of lack of salesmen and of substantial dealer support, however, the advertising program of the company had enabled it to attain 100% distribution of its products in drug stores and to make annual sales between $2,000,000 and $3,000,000. Nevertheless, sales in 1933 were more than 30% under sales in 1929.

Benson soap, the major product of the company, competed with a variety of other soaps. Most medicated soaps sold at retail for 25 cents, but a few sold for as much as 50 cents. Nonmedicated soaps were much lower in price, but they competed directly with Benson soap because of the health-value appeals used in advertising them and because of their economy for general-purpose uses.

In June, 1933, the company commenced to sell its products in small sizes to variety chains. The 10-cent sizes contained slightly less than two-fifths of the quantity in the regular 25-cent sizes. This quantity-price relationship and the convenience of the larger sizes were expected to shift the purchases of new users from the variety stores to the drug stores as soon as these users became acquainted with the merits of Benson products. The 10-cent sizes were sold to variety chains at $10 a gross in quantities of less than 5 gross and at $9 a gross in quantities of 5 gross or more.

Previously the company had attempted to reach new users by inserting a free-sample coupon in its newspaper advertisements. The coupon method of sampling, although it had attracted a large number of replies, had not been entirely satisfactory. Some people were unwilling to go to the bother of clipping a coupon and sending it to the manufacturer. Other people, moreover, abused the free-sample offer by using fictitious names to obtain an excessive number of free samples. These difficulties, combined with the willingness of variety chains to sell Benson products, induced the company to distribute through variety chains.

The Benson Company in September, 1934, was selling an average of 1,000 gross of its 10-cent items a month to four large variety chains. This business was not supported by either special advertising or salesmen, since the Benson officials had no desire to expand further the variety chain business. There was no indication, however, that the old distributors objected to sales to variety chain stores, because sales through the regular channels had increased during 1934.

What changes, if any, should the management have made in the promotional program in order to increase the volume of sales?

3. JENNER AND COMPANY

PROMOTIONAL STRATEGY FOR NEW PRODUCT

In the summer of 1927 Jenner and Company decided to add a new specialty to its line. This specialty was a liquid insecticide called "Extermo" and was similar to Flit and Flytox, which were widely advertised products.[1] In the company's opinion, Extermo was fully as satisfactory as any other insecticide on the market. By January, 1928, the company, whose plant was located in Massachusetts, had built up a reasonable sales volume in its local territory among users buying in large quantities and in bulk. Among such users were hospitals, restaurants, hotels, and various other institutions. The company's next step was to develop a market among household users.

The main products of Jenner and Company were sold in the industrial market. One of the executives of the company, who was manager of the specialties department, was particularly interested in their sale to consumer markets; he was of the opinion that the public, as a result of the extensive advertising of Flit and Flytox, had come to prefer a liquid insecticide used as a spray to the older type of powder insecticides and that the demand which had been created among consumers was for a type of merchandise rather than for a particular brand. Interviews with selected retailers had confirmed this opinion.

In order to reach the household market, sales effort was directed at unit drug stores by means of an attractive introductory offer described in a mail circular. The manager of the specialties department reasoned that the company which manufactured Flit, for instance, depended on extensive advertising to consumers to stimulate sales, rather than on the cooperation of retailers; this left the way open for manufacturers seeking only local distribution to secure sales by making their products particularly attractive to retailers. Jenner and Company did not seek distribution in chain drug stores since it was understood that chain stores customarily sold only those items for which a demand had already been created.

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[1] According to progressive independent store operators in the territory served by Jenner and Company, suggested prices of Flit at the time of Jenner and Company's offer were 8 ounces, 29 cents; 16 ounces, 49 cents; and 32 ounces, 79 cents. At these prices there was a retail markup of 33⅓% on Flit. These dealers reported that price cutting frequently reduced the margin to 25%.

Nor was distribution desired immediately in metropolitan Boston. It was thought that retailers in city areas were less likely to be influenced by special inducements to give sales attention to particular items than were smaller retailers in towns and outlying areas.

Although by the foregoing plan the company had obtained about 1,000 retail outlets for its products, direct sale to retailers had to be abandoned in 1933 because of difficulty in making collections. According to the manager of the specialties department, retailers, in order to maintain a good credit standing with the wholesalers from whom they bought most of their merchandise, were very prompt in meeting their wholesale obligations; but they did not show the same punctuality in paying manufacturers. The accounts of the latter were usually the last ones which the retailers paid. For this reason the Extermo division of the company, which had recently been separately incorporated, abandoned direct selling to retailers and started selling entirely through wholesale druggists and wholesale grocers. By 1934 the company's products were carried by 40 wholesalers, who were given discounts of 20% from the price to retailers.

Under the new plan of wholesale distribution, each spring the company mailed a broadside to independent retail drug and grocery stores throughout the East, explaining the proposition which the company had to offer. With the broadside were included leaflets describing the uses of Extermo. The broadside for 1934 read in part as follows:

THE EXTERMO DEALER CAN SMILE AT COMPETITION

Sometimes national advertising may be helpful to the retailer and sometimes otherwise. It is for the individual retailer to consider local conditions on specific items and determine what is best for his own interests and those of his customers.

Let us consider the handling of liquid insecticide from this standpoint. Here is an item on which the aggregate sale, while substantial and growing, is nevertheless limited and seasonable. While national advertising of a brand makes a demand for that brand, the independent retailer often finds himself whipsawed between two evils: First, in the brand being carried by every possible store in the community, thus reducing opportunity for him to develop volume. Second, it almost invariably results in cut prices, especially by the chain stores. The greater the national advertising the more the chain store advertises cut prices to feature that product as a bargain. With both volume and profit reduced to a minimum it soon becomes an unprofitable item —most of the business going to the cut-rate or chain store.

Instead of national advertising and chain-store distribution we extend a liberal offer to your customers by our coupons AND HELP YOU SELL EXTERMO.

These coupons bear your imprint and are redeemed only at your store. [See illustration of coupon in Exhibit 1.]

You have these coupons put into the homes in your locality, either by enclosing with bundles, by mailing, or by house-to-house distribution as you may prefer. Effective distribution never fails to bring good sales of Extermo and in addition these coupons are proved business builders in bringing new customers to the store.

We supply these free with your imprint so that you get the full benefit of the advertising and even limited distribution has always started a nice sale for our dealer.

Excellence of product ensures repeat sales. Your profit is generous and your customer receives incomparable value.

YOU CAN SELL EXTERMO 8-OUNCE SIZE FOR 25 CENTS, EXTERMO 16-OUNCE SIZE FOR 50 CENTS, AND MAKE 33⅓% PROFIT ON SELLING PRICE. YOU CAN SELL EXTERMO 16-OUNCE SIZE AND SPRAYER FOR 75 CENTS OR EXTERMO 32-OUNCE SIZE FOR 75 CENTS AND MAKE 30% PROFIT ON SELLING PRICE.

In this circular the company made an introductory offer, as follows:

Introductory Assortment	Usual Price a Dozen	Cost of Introductory Assortment
Extermo, 8 oz., 1½ dozen	$2.00	$ 3.00
Extermo, 16 oz., 1 dozen	4.00	4.00
Extermo, 32 oz., ½ dozen	6.30	3.15
Sprayers, ½ dozen	2.30	1.15
		$11.30

With this introductory assortment we send a large-size window display card, counter-display card, window banners, and special sale stickers, together with 250 colored coupons with dealer's name and address printed thereon.

The delivery of this assortment was made by wholesalers. Salesmen of wholesalers were expected to seek orders from retailers on the basis of interest stimulated by the mail distribution of circulars.

On the coupons distributed to ultimate consumers were printed a picture of the bottle of Extermo, a statement that the coupon was valuable, a series of ruled squares containing statements regarding the use of the product, and a section of cartoons. The part of the coupon showing the dealer's name is reproduced in Exhibit 1.

EXHIBIT 1
JENNER AND COMPANY
Facsimile of Coupon

THIS COUPON IS VALUABLE!			
(16 oz.) 60c SIZE (8 oz.) 35¢ SIZE	10 CENTS LESS WITH THIS COUPON	$1.00 (32 oz.) SIZE	25 CENTS LESS WITH THIS COUPON
COUPON GOOD AT THIS STORE UNTIL USED		FRED JONES COMPANY 200 MAIN STREET PITTSFIELD, MASSACHUSETTS	

The officers of the company considered the new program of promotion fairly successful. In August, 1934, Extermo was on sale in approximately 2,000 retail drug and grocery stores. While wholesalers as a rule did not give the matter of coupon distribution a great deal of attention, they did cooperate in providing lists of their retail dealers. Although there was considerable waste of coupons through the inattention of dealers, from 50% to 75% of the retail stores selling Extermo did distribute the customer coupons. It was expected that the coupons would cause customers to take advantage of low prices and at the same time encourage the dealers to maintain the regular established prices.

Should the management have made any further changes in its promotional program?

4. TWIN DISC CLUTCH COMPANY

PROMOTION OF A HYDRAULIC TORQUE CONVERTER

During the summer of 1940, Mr. Gilbert, the vice president in charge of sales of the Twin Disc Clutch Company, was attempting to formulate a plan of promotion for the company's newest product, a hydraulic torque converter. This product had not yet been released

to the sales department for general distribution, but Mr. Gilbert wished to be in a position to make specific recommendations when the president decided that it was ready for promotion.

The Twin Disc Clutch Company for many years had manufactured a line of clutches for use in tractors, boats, power shovels, and oil field equipment and, in fact, in almost all types of power-driven industrial equipment that had to be started and stopped frequently. The executives had always placed great emphasis on keeping the company's products technically superior to competitive products. Thus Twin Disc clutches had gained wide acceptance among industrial motor manufacturers, who had incorporated them into their products, as well as among other users of this type of clutch. Since the company's output was sold largely to be used as an integral part of a complete machine, the activities of the sales manager and the eight salesmen consisted primarily of convincing motor manufacturers that they should adopt the clutches as standard parts. The salesmen, who were all engineers, were expected also to help these manufacturers with any problems which arose in connection with clutches. It was from this source that many of the improvements in the company's products had developed. In addition to six branch offices from which the salesmen worked, the company had 40 service stations scattered throughout the country. These service stations were industrial equipment dealers, who purchased a supply of repair parts from the Twin Disc company and were given instructions as to the care of the products. All the company lines were sold regularly to about 750 customers, of whom 350 were very small. In fact, Mr. Gilbert estimated that 80% of the total output was sold to 100 customers.

In considering the position of the company with regard to the hydraulic torque converter, Mr. Gilbert reviewed the history of the development of marine gears, the only other nonclutch product which the company manufactured. In 1925 the engineers had done some experimental work with marine gears and, in fact, had made up a few sets for demonstration purposes. A market had failed to develop, however, and no manufacturer of marine motors would commit himself to a production order of the gears. Since the sales volume of clutches was very satisfactory at this time, the executives had decided to postpone all efforts to promote the new product. In 1932 a customer inquired about the gears and, after a careful examination of their merits, placed an order for a substantial

number. With this inspiration the engineers resumed work with the gears and developed various sizes suitable for nearly all types of marine engines. When all the data had been assembled, they were made available to the salesforce in concise form. Since most of the marine engine manufacturers were already purchasing Twin Disc clutches, the salesmen did not have to seek out new customers for the gears. But the manufacturers hesitated to incorporate the gears in their products, because there was no demand from the users of the engines. Therefore the Twin Disc company undertook an advertising campaign in the yachting journals and in the magazines of the fishing and marine industries. The competitive products on the market at this time were considered unsatisfactory by a majority of users, and soon there were a number of inquiries concerning the Twin Disc gears. The company was able to furnish several sets to be installed in boats already in operation; and after a year or two, engine makers began to build these gears into their products. In the beginning, there was a certain amount of field trouble. But the company immediately established a policy of replacing every weak part and of guaranteeing the satisfactory performance of all the gears. By 1940 the marine gears were widely accepted by manufacturers and users alike, but the company continued to advertise them regularly in the industrial journals.

In 1936, in an effort to discover new products which the Twin Disc company might manufacture, the executives inserted an advertisement in a newspaper, inviting people with ideas to submit them to the company. Although none of the suggestions which grew out of this advertisement proved to be of direct value to the company, Mr. Gilbert, who examined most of the proposals, was impressed with the large number of ideas for hydraulic devices which were turned in. He began to study the whole subject with great interest. In the latter part of 1936 he interviewed a man in New York who wished to develop a hydraulic torque converter. The man did not have his thoughts organized very clearly and, in fact, was mainly interested in obtaining a position in which he could work on the idea. A few weeks later, one of the company's officers learned that a Swedish concern was manufacturing a hydraulic torque converter to be used on buses and rail cars. During the following summer the president of the Twin Disc company, while traveling in Europe, investigated the Swedish hydraulic torque converter. He was impressed with its merit and consequently

negotiated a license to use the basic patent to manufacture the device in the United States for the industrial market.

This hydraulic torque converter was described by a company bulletin as follows:

> The Twin Disc Hydraulic Torque Converter is a hydraulic unit, which, when used in connection with an internal combustion engine, permits constant speed operation of the engine regardless of the speed of the driven unit.
>
> The dropping, torque-speed characteristic . . . , especially advantageous for the starting and acceleration of heavy loads, will be obtained at the output shaft of the converter in the form of high torque at low speeds, which is reduced automatically as the speed increases. Even with the output shaft of the converter completely stalled, due to extreme load conditions, the engine cannot be stalled but will continue running at its normal operating speed. Under these conditions, a maximum of approximately five times the engine torque will be available on the output shaft of the converter.
>
> The construction of the converter is based on the hydrokinetic principle. Its operation depends on the circulatory movement of the fluid for the transmission of power. Because the hydraulic drive does not require a rigid connection between the engine and the driven equipment, the fluid drive, attained with a converter, absorbs the cyclic variations of an engine, shock loads, and provides for extremely smooth starting of the load.
>
> The hydraulic portion of the converter consists essentially of three major parts . . . : the pump, the turbine, and the stationary housing.

When the president returned to the United States, he met with the other officers of the Twin Disc Clutch Company and mapped out a five-year program for developing the various applications of the converter and redesigning it in such a manner as to lower its manufacturing cost. For the purpose of working out these problems, the executives established a special department, consisting of five engineers, completely independent of the regular engineering department. One of these men went to Europe, where he studied manufacturing methods and applications of the product. After reading his report, the officers decided that the safest move would be first to apply the device to the same product on which it was used in Europe—a rail car. One of the car manufacturers agreed to furnish a car on which the company could make its experiments. This converter quickly proved successful, and the company's next step was to examine other possible uses. A list of products which were driven by internal combustion engines was made up, and the engineers carefully examined each possibility.

By the early part of 1939 the officers believed that the product was sufficiently developed so that it might be given some publicity. Several scientific papers containing technical information in charts and diagrams were drawn up and presented at meetings of engineers. At the same time editorial write-ups were prepared and published as news items in the magazines of a number of industries. As a result of these activities, inquiries were received from several sources, and installations were made in new equipment. The salesmen were given information on the product, with the thought that they would be in a position to discover new uses and leads without actively soliciting business. In the spring of 1939 the first advertisement of the product appeared in the *Oil and Gas Journal*, in connection with the annual oil show The advertisement was of a nontechnical character and merely emphasized the fact that the converter could make an internal combustion engine perform like a steam engine. In addition, a booklet containing a description of the product and a statement of what it could do was printed for distribution at the oil show.

In the meantime the company had developed several other applications of the converter, particularly for use in the lumber industry. The lumber industry in the Northwest was expanding very rapidly, and much new equipment was being purchased. Therefore the company inserted advertisements in the *West Coast Lumberman* in an effort to solicit the business of the users. Again the advertisements were not technical but encouraged the users to investigate the possibilities of the hydraulic torque converter before they purchased equipment requiring internal combustion engines. At the time of the 1940 oil show the company executives were able to persuade several manufacturers to exhibit the converter in connection with their products, in order that its many possibilities might be demonstrated. Meanwhile advertisements were placed in several of the oil field papers.

Until the summer of 1940 all the work in development and promotion had been undertaken independently of the general sales department, according to the original plan. Such rapid progress had been made, however, that the executives believed that it might be advisable to turn the product over to the sales department before the five-year period expired. One of the difficulties encountered in releasing the converter for general distribution was the fact that it could not readily be made a standard product. In each case

the device had to be adapted not only to the motor but also to the type of equipment being driven, with due consideration to the work which that equipment was expected to perform. This difficulty was particularly important in connection with the installation of the device in machinery already in operation. The company had received many inquiries from users of machinery who wished to change the character of their power by using a hydraulic torque converter. The engineers had investigated many of these inquiries and had made a number of installations. For example, in one case they had repowered a shovel; but a company engineer had had to supervise the final installation. In such instances it was necessary to include the cost of installation in the price of the product, since a person who was unfamiliar with the product could not install it in such a manner as to insure its successful operation. With this cost included, the converters were priced at $600 to $2,000. An effort was being made to train the company's salesmen to supervise installation.

In considering the market for the hydraulic torque converter, Mr. Gilbert had estimated that 75% of the possible volume lay within the group of customers to which the company was already selling clutches (see Exhibit 1). Although the converter had not been developed to the point where it could be manufactured cheaply enough to be used on the farm tractor, Mr. Gilbert believed that this market might some day be available. In the meantime he believed that oil field drilling, lumbering, material handling, and diesel locomotives furnished the best immediate outlets for the product, and suggested that promotion work be directed toward this group of industries.

EXHIBIT 1
TWIN DISC CLUTCH COMPANY
Percentage Sales of All Products

	Percentage of Total Sales Volume
Clutches for:	
Machine Tools	25%
Material Handling Equipment	25
Agricultural Implements	25
Oil Field Equipment	10
Marine Gears	10
Hydraulic Torque Converters	5

The Twin Disc advertising of clutches and marine gears was already reaching these fields. In 1939 the company had spent

$40,000 for business paper advertising. The magazines included *Business Week*, *Automotive Industries*, *Machine Design*, *Machinery*, *Iron Age*, *Pacific Motor Boat*, *Waterways Journal*, *Fishing Gazette*, *Oil and Gas Journal*, and *West Coast Lumberman*. In addition to the space taken in magazines, the company placed advertising in the annual catalogues of the major industries to which its products were sold, including *Diesel Progress*, *The Tractor Field Book*, and *The Paper Industry and Paper World*. Detailed catalogues and data sheets were drawn up to show the performance and indicate the possible acceptance of the company's products. The total advertising expense amounted to somewhat less than 2% of sales. No use was made of missionary salesmen, except in the sense that the two or three men being trained for sales promotion work occasionally called on prospective users with regard to particular problems and indicated the way in which the Twin Disc Clutch Company might help them solve these problems.

What recommendations should Mr. Gilbert have made for the promotion of the hydraulic torque converter?

5. FOLLIN OIL COMPANY

RECIPROCITY

The Follin Oil Company, with main offices in Chicago, was one of the major oil companies in the United States. The company was a completely integrated unit in the petroleum industry, controlling large oil fields, as well as refineries and widespread distribution systems. For several years prior to 1929 the company, together with other oil companies, had engaged in intensive competition, with the result that reciprocal relationships had become fairly common. The depression following 1929 had operated to intensify the interest of the industry in problems arising out of reciprocity.

In the spring of 1931 the attention of the purchasing director of the Follin Oil Company was called to a letter which was being sent out by Smith Brothers, Inc., the local distributor for the Universal Motor Car Corporation, to all the owners of Speedite automobiles registered in Chicago. The letter was as follows:

SMITH BROTHERS, INC.
Distributor for
Universal Motor Car Corporation

Speedite, Ladue, Champlain Passenger Cars — Universal Trucks

Chicago, Illinois
March 1, 1931

U Mr. L. M. Blanchard
S 1356 Ashley Rd.
E Chicago, Illinois

S DEAR MR. BLANCHARD:
H
A As an owner of a Speedite automobile you are vitally inter-
K ested in maintaining your automobile in a condition of efficiency.
E Spring will soon be here with its call to the open roads. Will your
R car be in condition to render trouble-free service?

M For the next three weeks our service department is featuring a
O special spring tune-up service. The carbon will be removed from
T your motor, the valves ground, the carburetor adjusted, the
O distributor points cleaned and adjusted, and the entire car care-
R fully inspected, tightened, oiled, and greased for the special
price of $16.50. The regular price for the work is $20.00.

O
I We recommend that the oil in the motor be changed after
L every 500 miles of driving. Shaker oil has proved to be satis-
S factory and is recommended for use in the cars and trucks which
we distribute.

Yours for service,
J. C. SMITH
Smith Brothers, Inc.

SHAKER MOTOR OILS ARE MADE FROM 100%
PENN CRUDE OIL

Shaker oil, which Smith Brothers, Inc., recommended in its letter, was a product of the Shaker Oil Company, one of the smaller competitors of the Follin Oil Company. The Shaker Oil Company was not a completely integrated unit and did not own a distribution system. It specialized in motor oils of the highest grade; and its products were distributed through independently owned filling stations, through garages, and when possible through service departments of motor car dealers. In the spring of 1931 some of the larger oil companies were making definite attempts to force Shaker oils out of the independently owned filling stations and garages by

refusing to sell gasoline and oils to those filling stations and garages which sold Shaker oils.

The purchasing director of the Follin Oil Company was responsible to a large degree for his company's reciprocal relationships. The sales department had a voice, however, in all discussions concerning reciprocal relationships; and in exceptional cases where there was controversy between the purchasing department and the sales department, the president of the company decided the issue. The purchasing department maintained a record of all its purchases and submitted reports from time to time to the sales department showing from which suppliers the company was buying materials and equipment required in its operations. On some occasions when the company's salesmen had not been given an opportunity to present their products to companies from which the Follin Oil Company was buying, the purchasing director had communicated with these suppliers, reminding them that their salesmen were given an opportunity to interest the Follin Oil Company and expressing the hope that salesmen from his company would be accorded the same privilege when they again called on the suppliers.

When the letter sent out by Smith Brothers, Inc., was brought to the attention of the purchasing director, he requested a clerk to determine the amount of the purchases made from the Universal Motor Car Corporation during the preceding three years. It was found that the Follin Oil Company and its subsidiaries had purchased motor cars and trucks to an approximate value of $750,000 annually. The purchasing director believed that this volume was great enough to make his company one of the largest individual customers of the Universal Motor Car Corporation.

Not all the $750,000 volume of business was placed with Smith Brothers, Inc., since many of the subsidiaries of the Follin Oil Company were located in other parts of the country, and cars and trucks were delivered to them through the local dealers serving their territories. Smith Brothers, Inc., however, received over $100,000 of the oil company's motor car and truck business each year. The purchasing director estimated that the annual volume of sales by Smith Brothers, Inc., of oils comparable to those produced by the Follin Oil Company was between $75,000 and $125,000.

In considering this problem the purchasing director had a choice of three courses of action: he could ignore the fact that the motor car dealer was recommending the use of a competitor's oil; he could

proceed on a basis of reciprocity and demand that the dealer recommend Follin oil; or he could take the matter to the executives of the Universal Motor Car Corporation and ask them whether they believed that the Follin Oil Company was receiving fair treatment at the hands of Smith Brothers, Inc.

The purchasing director of the Follin Oil Company was a member of the local chapter of the National Purchasing Agents' Association and on friendly terms with the purchasing agents of a number of noncompeting companies. He knew that there were a considerable number of companies in the United States which had established separate departments whose whole responsibility was to supervise reciprocal purchase and selling relationships. While considering the proper course to take with respect to the problem presented by Smith Brothers, Inc., he discussed with three purchasing directors the policies of their companies and the problems encountered in administering those policies. For his own analysis he summarized these conversations as follows.

LINCOLN ELECTRIC COMPANY

The Lincoln Electric Company, a manufacturer of electric welding equipment and motors, with annual sales of $5,000,000, adhered rigidly to a policy of nonreciprocal buying. The management believed firmly that over a period of time only the most efficient producers would survive; consequently the purchasing agent was instructed to select materials and vendors only from the standpoint of maximum real economy. The difficulties of adhering to this policy were illustrated by two instances typical of many others.

For a number of years, the Lincoln Electric Company had purchased welding wire from the Pennsylvania Steel Corporation. Annual purchases averaged $250,000. In 1929 the purchasing agent had found another reliable supplier whose efficiency enabled him to sell the same quality of welding wire at a reduction of 10 cents a pound. Since this reduction would effect an appreciable saving for the Lincoln company, the purchasing agent accepted the offer. Thereafter, the Pennsylvania Steel Corporation, whose annual purchases of Lincoln equipment averaged $25,000, refused to place any further orders. Moreover, the Pennsylvania Steel Corporation, in an effort to regain the business, dropped its price on the welding wire well below that of its competitor. Nevertheless, the Lincoln company, believing the cut to be a temporary

expedient to drive out competition which would be followed, if successful, by higher prices, did not return its patronage to the Pennsylvania Steel Corporation.

Another instance had developed when the E. F. Hauserman Company, from which the Lincoln company purchased steel partitions, suffered a serious fire. A contract totaling $10,000 for machinery destroyed by the fire was awarded the Lincoln company by the E. F. Hauserman Company. Following installation, the E. F. Hauserman Company was notified that the Intercontinental Electric Company, one of its customers, resented its use of the Lincoln equipment and therefore would not make any further purchases of Hauserman products. Fearful of the loss of the Intercontinental Electric Company's business, which had been a substantial volume each year, Mr. Hauserman sold the installed Lincoln equipment for junk, accepting thereby a loss of $5,000, and immediately purchased Intercontinental equipment.

Shortly thereafter, the Lincoln Electric Company was in the market for a substantial quantity of steel partitions. The prices quoted by the E. F. Hauserman Company were satisfactory; the purchasing agent of the Lincoln company was convinced that the quality of Hauserman material was better than that of any of its competitors; therefore, adhering strictly to its established policy of nonreciprocal buying, the Lincoln company purchased Hauserman partitions.

BLANCHARD COMPANY

The Blanchard Company, a manufacturer with annual sales of heavy machinery of all types amounting to $27,000,000, had followed a policy of buying from customers whenever the customers could furnish materials of a quality, at a price, and with service equal to those offered by other suppliers. The general purchasing officer received a monthly report from the sales department, listing all quotations sent out by the company and all sales orders received by the company. This system enabled the general purchasing agent to know who were customers and prospective customers. Conversely, the sales department received a monthly report from the purchasing department showing the names and addresses of all suppliers from whom the company had made purchases of $300 or more during the previous month. Although these facts were not used forcefully when orders were solicited, a prospective customer

who had received orders from the company was reminded of that fact. The Blanchard Company, however, placed primary reliance in seeking business on its reputation as a builder of high-quality machinery and on its ability to render prompt and efficient service.

The Blanchard Company had annual requirements of 1,200 tons of cold-rolled bar steel. At a price of $40 per ton this amounted to $48,000 per year. Prior to 1930 the entire quantity had been purchased on an annual contract from the Coppel Steel Company, a small but low-cost unit which bought its material from the Pennsylvania Steel Corporation. In 1930, however, the purchasing officer had given considerable thought to dividing the company's requirements among three steel companies, each of which produced steel of standard quality and each of which quoted the same price.

From the records of the sales department, the general purchasing agent discovered that the Coppel Steel Company had purchased nothing from the Blanchard Company in 1929 or 1930; the Terrell Steel Corporation of Ohio had purchased $108,000 worth of the company's products in 1930; the Bazore Steel Company of Buffalo had purchased $20,000 worth of the company's products in 1930; and the Pennsylvania Steel Corporation had purchased $400,000 worth of the company's products in 1930.

The purchasing officer was convinced that it was wise whenever possible to have at least two sources of supply for all the major materials required by the company. He believed that, in general, purchasing from several sources rather than from one gave greater protection against failure in material supply, resulted in better service and prices except where quantity discounts had to be considered, and aided the sale of the company's products through the patronizing of more of the company's customers. He recognized, on the other hand, that by giving orders for all the company's requirements of one material to a single supplier the business would be more valuable to that supplier, and hence greater efforts would be made by the supplier to render service, meet the company's demands in times of emergency, and quote the best possible prices.

On the basis of these considerations the purchasing agent awarded the new steel contract as follows:

Coppel Steel Company	$30,000
Terrell Steel Corporation	13,000
Bazore Steel Company	5,000

These amounts were roughly in proportion to the steel companies' purchases from the Blanchard Company (counting the Coppel Steel Company as representing the Pennsylvania Steel Corporation).

Shortly thereafter a representative of the sales department of the Pennsylvania Steel Corporation called to protest the reduction in the contract awarded the Coppel Steel Company. After hearing the reasons for the reduction, he argued that, since the Pennsylvania Steel Corporation bought four times as much from the Blanchard Company as the others, the entire award should go to the Coppel company. His final statement was that, unless the Coppel Steel Company received the entire order from the Blanchard Company, the Pennsylvania Steel Corporation would be forced to place its orders elsewhere for the type of machinery manufactured by the Blanchard Company.

In the face of this demand, the purchasing officer went to the director of purchases for the Pennsylvania Steel Corporation and explained his purchasing policy. The director of purchases agreed that the policy was sound and promised to talk with the sales department of his company. As a result, the Pennsylvania Steel Corporation stated that it was satisfied that it was getting its share of the Blanchard business.

DINIC COMPANY

The Dinic Company, one of the largest manufacturers of machine tools in the United States, had no definite policy with respect to reciprocal buying. Prior to 1930 the problem had not been serious, and the purchasing officer had dealt with each question separately. As a result of depressed conditions in 1930 and 1931, however, industrial companies were using all means to secure sales, and demands for reciprocal treatment were common.

Early in 1931, the Dinic Company received an order from the Wash-Reklaw Company for one new lathe to be built to the order of the Wash-Reklaw Company at a contract price of $1,500. Attached to the purchase order from the Wash-Reklaw Company was the notice given on the following page.

Note: Please refer this to the management and to your Purchasing Director. It is important.

ORDER ATTACHED!
The Following Refers to
FUTURE ORDERS

In these times it is necessary to leave nothing undone that will motivate toward more sales. You are, no doubt, like everyone else, particularly anxious at this time to bring in more and more orders. So is the Wash-Reklaw Company, in which all hands are doing their part to keep our volume up to a good point.

This message is our Purchasing Department's contribution toward order-getting.

We know that you appreciate the attached order, whether it is large or small, whether it is one of many you are constantly receiving from us, or whether it is the first we have ever sent you. It is proof positive that we like your product, your price and your service,—or we would be sending it to your competitor.

Our products are as follows:

1. Steel filing cabinets for all purposes.
2. Steel Skyscraper desks.
3. Fire protective devices—safes and Fire-Files.
4. Indexing and supplies.

and

5. Every printed form you use, except your letterheads.

This last item includes:

1. Factory and Shop Forms.
2. Sales Record Cards.
3. Office Forms.
4. Purchasing Records.
5. Employment Records.
6. Stock Records.
7. All Accounting Records.

. . . and so on down the diverse line of forms and records you must use daily.

Now, we can produce anything you use, on any kind of paper or card stock that your price requirement demands.

In consideration of the attached order from us, we ask that you send us a sample of all the card forms you use. Tell us what quantity you buy, how often, and how much you pay. By ordering what you need from us, you can get the quality, service and price that you want.

As we and your other customers increase, so will you increase. Why not apply this idea to your own purchase orders? We believe that the application of this idea in all lines would immediately and *materially* stimulate business throughout the country.

We are attaching these sheets to all our purchase orders and are keeping a close check on the results. We are looking forward to seeing your card samples,—also, please remember that we can furnish any indexing system or supplies you may need.

Let us hear from you! Please address your reply to Director of Purchases, care of this office.

BUY NOW FROM WASH-REKLAW, INDIANAPOLIS, INDIANA

The sales department of the Dinic Company referred the notice to the purchasing director for whatever action he wished to take. His first step was to investigate his company's past sales to the Wash-Reklaw Company. He found that during the preceding five years the Wash-Reklaw Company had purchased Dinic equipment with a value of $4,000. During the same period the Dinic Company had purchased products from the Wash-Reklaw Company with a value of $3,000.

The Dinic Company had in the past standardized on Dakin-Graham filing cabinets, desks, and filing supplies. Most of the printed forms used in the company's operations were purchased from local printers. The purchasing director believed that, quality and service considered, he had obtained satisfactory prices from the suppliers. Relations with the suppliers had been very cordial, and the Dinic Company could always depend on prompt attention to its needs.

The Dakin-Graham Company had, during the preceding five years, purchased approximately $3,000 worth of equipment from the Dinic Company. During the same period of time the Dinic Company had purchased about $10,000 worth of supplies and equipment from the Dakin-Graham Company.

The purchasing director of the Dinic Company wrote to the purchasing director of the Wash-Reklaw Company explaining that it was against his policy to reveal prices paid for products. He stated, however, that he would be pleased to talk over his requirements with the Wash-Reklaw Company's salesman just as he would with the salesman of any other supplier.

An executive of the Wash-Reklaw Company explained his reason for sending out the notice as follows:

> I think it is self-evident that this notice carries to our suppliers a message of the items we make. We felt this was necessary, for the reason that ours is a very broad line and they might connect our company with only the manufacture of office files and desks and might forget that we manufacture forms of all kinds for office use.

What steps, if any, should the Follin company have taken to obtain the business of Smith Brothers, Inc?

What policy on reciprocal relationships should the officers of the Follin company have adopted for future guidance?

B. USE OF SALESMEN

1. BAKER BROS. SUPPLY COMPANY

MANAGEMENT OF SALESFORCE

In March, 1939, the sales manager of the Baker Bros. Supply Company was faced with the problem of replacing two salesmen, one of whom was retiring from business and the other leaving to accept the offer of a noncompeting concern. He believed that an excellent opportunity had arisen for a reconsideration of the company's sales organization.

The Baker Bros. Supply Company had been organized in the early 1920's to supply filling stations and bulk tank stations (wholesale gasoline plants) with pumps, storage tanks, truck tanks, meters, hose, and many smaller items of equipment, such as wire baskets for holding bottles of lubricating oil. The company manufactured a few specialty items in its own small plant, but most of its merchandise was purchased from other manufacturers. The company held exclusive agencies for some of the items in its line, while others were handled in competition with other supply firms.

The Baker Bros. Supply Company secured the greater part of its business in the New England states; but a considerable number of orders, particularly for specialty items manufactured by the company, came in by mail from outside this area. Certain of the major oil companies operating outside New England purchased their entire requirements of these specialty items from the company. Salesmen regularly covered only the New England states, although the salesman who handled the accounts with the major oil companies visited purchasing agents of these firms in New York and other cities.

Throughout the 1920's the number of filling stations in the territory served by the Baker Bros. Supply Company had increased rapidly, and sales rose in the course of 10 years from a few thousand dollars to approximately $750,000. During most of this period 80% of sales were made to customers who were establishing new filling stations and bulk tank stations. As the rate of increase in the number of filling stations fell off late in the 1920's, a marked increase in the use of fuel oil for house heating began. This development opened up a substantial market for the Baker Bros. Supply Company in the sale of truck tanks and other equipment to domestic fuel oil dealers. By 1939, however, the rate of increase in this business

also had declined. As a result, sales of the company had fallen to approximately $400,000, of which 90% or more represented replacement purchases. In only two years of the period from 1923 through 1938 did the company show a loss. (The balance sheet as of December 31, 1938, is shown in Exhibit 1.)

EXHIBIT 1
BAKER BROS. SUPPLY COMPANY
Balance Sheet—December 31, 1938

Assets		Liabilities	
Plant and Equipment (depreciated)	$17,432	Accounts Payable (trade)	$ 7,482
Inventories	23,212*	Notes Payable to Officer	5,000
Accounts Receivable (trade)	16,232	Miscellaneous Liabilities	1,212
Accounts Receivable (employees)	1,212	Capital and Surplus	56,497
Prepaid Insurance, Deposits, etc.	642		
Cash	11,461		
Total	$70,191	Total	$70,191

* A substantial proportion of sales, particularly of tanks and pumps, were shipped direct from manufacturer to buyer.

On major items, such as truck tanks, the company normally expected to secure a gross margin of 15% of sales. Although it was impossible to secure this margin on some highly competitive items, a few specialties carried a margin of 30%. In the years between 1935 and 1939, the gross margin for the company as a whole ranged between 12% and 14%.

The company did no space advertising except in programs for trade association dinners. An attractively illustrated catalogue was published each year, and relatively extensive use was made of direct-mail advertising. Over a period of years the company had built up a mailing list of prospects which was considered the best in the trade. The figures for the number of prospects by territories shown in Exhibit 2 were derived from this mailing list, which included in addition the names of 810 prospective customers located in Boston and 533 outside New England. Annual expenditures for advertising amounted to slightly more than 1.5% of sales.

The founder of the company had been a highly successful equipment salesman. On the basis of his own experience he was wholeheartedly in favor of giving salesmen wide scope for exercising their own initiative. He believed that, in a business where personal salesmanship was of major importance, best results came from treat-

ing salesmen as if they were independent businessmen. Accordingly, as the business expanded, salesmen were given territories within which they were permitted to govern themselves with little guidance or control. They were paid commissions which differed in rate for different items in the line. On tank trucks, for instance, the commission rate was 7% of the selling price, or just under half the company's margin on the item. Commission payments to salesmen ordinarily averaged between 6% and 7% of their sales. For a number of years the company gave salesmen no drawing accounts and made no provision for advances to them. In the early 1930's, however, the company began to make advances to salesmen during the three dull months of January, February, and March. By 1939 this practice had developed into the granting of drawing accounts to five of the salesmen. Salesmen paid their own traveling expenses out of commissions. The company executives had no exact knowledge of expenditures made by salesmen for traveling, but they estimated that the expenses per salesman ranged from $1,000 to $2,000 a year. In conformity with the president's general ideas, salesmen made no reports to the central office on their activities and were free to decide on the prospects to be called on, the frequency of call, and the route to be followed on trips.

In March, 1939, the sales organization of the company was made up of a sales manager, seven outside salesmen, and two young men who handled mail orders, dealt with customers who came to the main office, and took care of a considerable mass of clerical work. Of the seven outside salesmen one devoted his full time to the major oil companies, calling not only on central purchasing agents but also on district managers, in the effort to induce the latter to specify Baker Bros. equipment when placing requisitions. The six remaining salesmen were assigned to the territories shown in Exhibit 2. The city of Boston was not included in any territory because the president believed that the sales manager and the office salesmen could handle this business. Since these men were paid salaries, the president considered the sales of $10,386 made in the city in 1938 to 86 customers as "velvet."

Mr. Hicks, who had the eastern New Hampshire and southern Maine territory, was a man in his fifties who had been employed in 1937. For many years he had been a salesman of filling station equipment and had earned $5,000 to $6,000 annually. He was not a technically trained man, but because of his long experience he was

able to supervise the installation of tanks and other equipment. The company did not provide installation crews for setting up storage tanks and the like, but customers expected salesmen to be able and willing to direct the work of local contractors. Mr. Hicks was far from satisfied with his current earnings, although he recognized that changes had taken place in the business. He was particularly disturbed by his very low earnings in January, February, and March of each year. In all territories business was extremely dull during these months but especially so in the northern ones. Although the company sent Mr. Hicks approximately $60 a week throughout this period, the sales manager was certain that he did very little traveling. The sales manager realized that use of part of this sum to defray traveling expenses might leave Mr. Hicks without adequate funds to meet his living expenses, but he felt strongly that coverage of the territory during these three months was important. He argued that, while few purchases of equipment were made then, prospective customers were utilizing the period to make up their minds as to the equipment to be bought in the spring.

Mr. Haskell, who had Territory 2, was a relatively young man who had been with the company for about eight years. He was not particularly dissatisfied with his earnings because he had not experienced the higher earnings of the predepression period. In the opinion of the sales manager, however, he devoted too little time to individual prospects.

Mr. Burwell, in Territory 3, was in his late sixties, and in the course of his highly successful career as a salesman had accumulated savings sufficient to yield him a satisfactory income. He had not insisted on having a drawing account, therefore, and was not inclined to exert himself to develop new prospects. He tended to concentrate his limited efforts on accounts which had been friendly to him for many years. He planned to retire from active business on May 1, 1939.

Mr. O'Connell, who had the eastern Massachusetts territory including Worcester but excluding Boston and Cape Cod, felt aggrieved because he was not permitted to sell in Boston. He argued, and the sales manager was inclined to agree with him, that the company would be better off with active solicitation in Boston even if it had to pay commissions on Boston sales. The sales manager concurred with this point of view because the other duties of the central office salesmen limited active solicitation in Boston,

EXHIBIT 2
BAKER BROS. SUPPLY COMPANY
Summary of District Salesmen's Activities, 1938

Salesman	Territory	Number of Prospects	Number of Customers	Number of Orders	Sales	Commissions	Percentage	Remarks
1. Hicks	Eastern New Hampshire and Southern Maine	864	185	922	$ 42,706	$ 2,679	6.3%	Drawing Account of $3,000 Second Year in Territory
2. Haskell	Vermont and Western New Hampshire	952	176	745	36,524	2,170	5.9	Drawing Account of $2,500
3. Burwell	Massachusetts West of Worcester	582	110	496	16,331	1,122	6.9	No Drawing Account
4. O'Connell	Worcester and Eastern Massachusetts excluding Boston and Cape Cod	505	210	1,084	37,729	2,498	6.6	Drawing Account of $2,500
5. Parker	Rhode Island and Cape Cod	827	172	1,081	66,986	3,979	5.9	Drawing Account of $3,000
6. Blackstone	Connecticut	836	140	618	26,006	1,739	6.7	Drawing Account of $2,000
Total		4,566	993	4,946	$226,282	$14,187	6.3	

and sales in the city, therefore, were very low in relation to the number of prospects.

Mr. Parker, whose territory was Rhode Island and Cape Cod, had been the company's star salesman for more than 15 years. His net earnings in the late 1920's had been as high as $8,000 annually. He was very definitely a "high spot" salesman; that is, he was altogether unwilling to devote any effort to small accounts or to securing small orders for replacement items. The sales manager had argued repeatedly that, with the change in the character of the business from selling original installations to heavy emphasis on replacements, it was necessary to do a careful methodical job of cultivating a large number of prospects. Mr. Parker's stock reply to this argument was that he could not afford to do so, that it cost him too much to cover his territory if he spent time on small orders. He was constantly on the lookout for prospective purchasers of truck tanks, to whom the average unit sale would be $1,000, or for storage tank installations, in which the average unit sale was $500. Mr. Parker was extremely impatient of suggestions from the executives and seldom communicated with the central office except to send in orders. In the winter of 1938, for example, he had been ill and off the road for three weeks; and the sales manager had not discovered this fact until two months later, when he inquired why some responses to direct-mail advertising had not been followed up. The sales manager regarded this incident as an extreme illustration of an attitude common to all the salesmen. In fact, he believed that no more than 10% of the inquiries sent out to salesmen by the central office were actually followed up.

Mr. Blackstone, who had been with the company for a number of years, had become so dissatisfied with the prospects for the Connecticut territory that he had resigned to take a selling job with a noncompeting manufacturer.

The activities of these six salesmen during the year 1938 are summarized in Exhibits 2 and 3. The sales of the company above the $226,000 shown in Exhibit 1 represented sales to national accounts, mail-order sales outside the territory, and sales in the city of Boston. Some of the sales of $226,000 credited to the territories actually came in direct by mail, but salesmen received commissions on all business in their territories except that with national accounts.

EXHIBIT 3
BAKER BROS. SUPPLY COMPANY
Salesmen's Activities Classified by Size of Customer, 1938

Salesman	Annual Purchases $100 or More			Annual Purchases Less than $100		
	Number of Customers	Number of Orders	Sales	Number of Customers	Number of Orders	Sales
1. Hicks	63	555	$ 36,748	122	367	$ 5,958
2. Haskell	38	238	27,464	138	507	9,060
3. Burwell	18	144	10,832	92	352	5,499
4. O'Connell	73	587	32,020	137	497	5,709
5. Parker	43	501	55,252	129	580	11,734
6. Blackstone	55	395	22,813	85	223	3,193
Total	290	2,420	$185,129	703	2,526	$41,153

The sales manager proposed to the president that the two salesmen who were leaving should be replaced on a radically different basis. He suggested that salesmen be employed at a fixed salary of $40 a week and that they be given $75 in cash and a $25 gasoline credit card every month to cover their expenses. Commissions were to be credited on sales at the usual rates. Any excess over salary and the cash advance for expenses ($2,980 a year) was to be paid to the men. The men were not to consider that they were in debt to the company during the dull periods or at any other time, because the $40 a week was definitely theirs. Salesmen were to be required to report daily the names and addresses of all prospects called on and to indicate at least one item of equipment in which each prospect was currently interested or might be in the future.

The president of the company did not approve of the proposal, but he finally consented to it with the proviso that the sales manager employ the two central office salesmen for the purpose. These were young men in their twenties with no education beyond high school and with no experience in selling. The sales manager pointed out that there was a great difference in the requirements in dealing with customers who had come to the office to make a purchase and in stimulating prospects to make purchases out in the territory. The two young men had adequate knowledge of the merchandise, but the sales manager considered that they did not possess the

personalities to make satisfactory salesmen. The president believed, however, that the risk of the venture would be minimized if these men were used, because they could return to the office jobs if they proved unsuccessful on the road.

What action should the executives of the company have taken on its sales management problems?

2. LARMON COMPANY

CONTROL OF MISSIONARY SALESMEN

Early in 1934 the sales manager of the Larmon Company, which manufactured a line of food products sold through grocery stores, undertook an analysis of the work of the company's missionary salesmen.

The company maintained a force of missionary salesmen in nearly every part of the United States. These salesmen called on both wholesale and retail grocers. They visited the wholesale grocers periodically to make certain that the latter stocked the company's products, and called on the retail trade to set up window and counter displays, to offer selling suggestions to the managers of the stores, and to take orders for the company's products. The salesmen turned over to a wholesale company for delivery most of the orders which they received from retailers, except in a few regions where the salesmen made actual deliveries from their trucks. In such instances the regular margin on the merchandise was allowed to the wholesaler who would ordinarily have received the business.

For a number of years the Larmon Company required its missionary salesmen to call on practically all the retail grocery stores in their territories. It allowed them considerable latitude in determining the proper routes necessary to reach most efficiently the different towns and cities in their districts, but it insisted that the salesmen should not neglect even the smallest retailer in the smallest town.

After a study of the report of the U.S. Department of Commerce on the grocery trade in Louisville, Kentucky, and of reports made by the Harvard Bureau of Business Research and other well-known organizations, the sales manager of the Larmon Company decided that his company's practice of requiring its missionary salesmen to

call on all retail stores must be decidedly wasteful. These surveys showed that over 70% of the retail food business was being done by 30% of the retail stores, that approximately another 24% of the business was being done by another 30% of the retailers, and that the remaining retailers furnished only about 6% of the sales. The sales manager concluded that if this proportion held in his own business, his salesmen were calling on innumerable stores which at best were responsible for an insignificant volume of sales.

The sales manager thereupon decided to make a comprehensive analysis of the daily reports sent in by the missionary salesmen, to see whether this situation obtained in his own company. In the past the branch managers of the company had studied these reports individually as they were sent in, but they had seldom tried to analyze them as a unit for a long period of time. In making this study, the sales manager planned to gather, for each salesman, the names of all towns that the salesman visited, the population of the towns, the number of calls made in them, the sales made, and the mileage covered for a complete round of the salesman's territory, which usually required about 90 days.

After examining the reports, the sales manager found that the salesmen were stopping in many towns where sales were seldom secured. One salesman, who took 66 days to cover his territory and who visited 174 cities and towns including one large city, obtained 73% of his sales from 8 cities with population of more than 10,000, 79% from 12 cities and towns of over 5,000, and 84% from 17 cities and towns of over 2,500. On one day this man traveled 192 miles, stopped in 11 towns, only 2 of which had a population of more than 1,000, and made no sales. A few days later he stopped in a large city and immediately made substantial sales.

Another man was on the road 88 working days, traveled 4,617 miles, and made 2,063 retail calls in 265 towns. Only 40 of these towns had a population of more than 2,500, but they furnished 79% of his sales.

A third man made 30 calls in one day in a city of 19,000 population, traveled 12 miles, and sold $112 worth of the Larmon Company's products. On another day this same man went 55 miles, stopped in 10 cities and towns, made 24 calls, and sold $25.05 worth of goods. On a later day this man traveled 85 miles, made 10 calls in 5 towns, and sold $141 worth of merchandise all in one town.

A salesman in another territory in one day stopped in 19 towns, the populations of which were as follows: 3; 37; 15; 6,819; 27; 1,863; 0 (no population listed in census); 28; 23; 540; 209; 130; 305; 402; 105; 181; 93; 540; 27. He obtained only a few dollars' worth of sales.

A fifth salesman, whose territory included a city of nearly 1,000,000 population, was on his route 136 days and stopped in 550 towns and cities. Out of this man's total sales of $11,952.50, the one large city supplied $7,692, and that city and 22 other places produced $8,797 in sales.

These figures convinced the sales manager that it was not worth while to have the salesmen stop in the small towns. He decided, on the basis of the past sales record, that any town having a population of less than 2,500 ordinarily did not purchase enough of the company's products to warrant a visit by a salesman. Before definitely dropping all such places from the call list, however, he studied separately the sales made in the past in each town, and retained on the call list those places which had shown adequate sales returns.

After eliminating the unprofitable towns from the call lists, the sales manager studied the manner in which the salesmen had formerly reached the towns in order to see whether the men had routed their trips to the best advantage. To aid in this work, he had enlarged photostats made of automobile road maps, indicating distances between towns and the conditions of the roads in the various territories. He then drew circles around all towns of 2,500 people or more and those smaller places where calls were considered to be worth while, and traced the salesmen's course over their territories.

This study produced information which the examination of the daily reports alone had not disclosed. For instance, it showed that one man, who had traveled 2,226 miles in 73 days and made 1,366 calls in 189 towns and cities, had traveled between 2 cities in his territory fifteen times during the period whereas he had not reached at all a number of other important cities in his district. The sales manager learned that one of the reasons for this poor routing arose from the salesman's desire to return to his home at night as often as possible. This incentive led him to make calls overfrequently in those towns on the routes to the city in which he lived.

As a test of the effect which rerouting might have on the efficiency of the salesman, the sales manager himself laid out what he considered a logical route for the man to follow in covering his territory, allowing him to stop only in productive towns and eliminating as much backtracking as possible. After this rerouting had been completed, the salesman took nine days to cover the same area which had formerly taken him over two months to cover; his sales during these nine days were 90% of those he had achieved in the two months' period.

After this test the sales manager decided that there was a definite need for redistricting and rerouting the entire salesforce, and he therefore set about the development of continuous routes for all salesmen with a minimum of backtracking. The information which he had already obtained regarding the mileage between towns and the number of retailers to be called on in each town helped him in changing the routes. He laid out the new routes in clover-leaf pattern from the various wholesale centers and divided the routes into five or six sections. The men were expected to spend about two weeks covering each section of their territories. At the end of a two-week trip, the sales manager planned that the salesmen would return home. After remaining at home a day or two, they were then to travel for two weeks more, covering the next section.

As a pattern for the work in other areas, the sales manager supervised the entire task of redistricting and rerouting one territory; but after this one was completed, he prepared only a preliminary outline map of what he expected should be done in other districts. He asked the managers in charge of the districts to complete the maps and send them back to the home office for final approval.

The district managers were expected to discuss the rerouting with the individual salesmen in order to give the latter an opportunity to present their views on the subject. The sales manager hoped that the salesmen would point out where mistakes in the plans had been made, because he recognized that they were much more familiar with sales and geographical conditions than were the officers of the company. In addition, the sales manager believed that, if the salesmen were allowed to have an influence in determining the new routes, they would be less likely to react unfavorably when the routes were decided.

After the cities to be called on had been determined, and the most efficient methods of reaching them had been laid out, the sales manager began selecting the retail stores which should not be visited in the cities on the call list. The Census of Distribution indicated that there were over 400,000 retail grocery stores in the country. The sales manager believed, however, that not over 250,000 were really grocery stores as he interpreted the term, and that the others were stores which carried a few groceries as side lines. Of the real grocery stores, he was convinced that over 50,000 went out of business and over 50,000 entered business each year. Retailers of this type, among others, he wanted to remove from the salesmen's call lists.

To help him in his task, the sales manager purchased portions of several well-known lists of the better-class retailers, which he submitted to his salesmen. The men criticized these lists severely, however, saying that many good retailers had been omitted and that many weak ones were included. He decided, therefore, not to consider those lists further.

The sales manager finally obtained a list of the 75,000 leading retail grocers in the country, which list, after test, he considered reasonably satisfactory for the company's purposes. He divided this list by territories and allocated the names to the proper districts. Until the salesmen had covered the new routes a few times and been given an opportunity to study the stores included on their lists, they were allowed to add to or subtract from the names on the lists, provided they gave sufficient reason for the change; but after some time had elapsed, the lists were considered as more or less permanent and were changed only when the listing company made its periodic revisions and when the salesmen brought into evidence special instances. The permanent lists were checked by the branch managers against the daily reports of the salesmen to make sure that the men made all the calls which were expected of them. In pruning its list of customers, the company did not go to the full extreme but reduced it only about 50%. This reduction was brought about slowly so as not to disrupt the organization. At a future date the sales manager anticipated a somewhat further reduction in the number of customers visited.

The company started the reorganization of its missionary salesforce early in 1934 and planned to develop its program, one district at a time, throughout the entire United States. The sales

manager expected that the whole program would be completed sometime in 1935.

The sales manager was very much pleased with the results obtained from the reorganization of the salesforce. By the fall of 1934 the company had saved over $125,000 in salaries and traveling expenses and had lost but little sales volume. In one territory, for instance, where the company was able to reduce its salesforce from 21 to 12, retaining only the most efficient men, in a nine months' period the total sales expense was reduced from 8.3% of total sales to 5.4%. During this same period the percentage of the cost of salesmen's salaries and expenses to the sales which they made during their retail calls was reduced from 45% to 21%, and the average number of retailers to whom the salesmen sold in proportion to the total number visited was increased from 25% to 49%.

In addition to the advantages of the plan which appeared directly in the figures, there were a number of less tangible features. The new sales program, for instance, made it possible for the salesmen to call on important customers much more frequently than they had done in the past, since they were not required to spend time visiting retailers who failed to buy. Also, an unforeseen advantage of the plan arose from its effect on the morale of the salesforce. The company had anticipated much opposition from the salesmen, but this opposition was evident only so long as the whole salesforce was maintained. Once the necessary cuts had been made, the remaining men became very enthusiastic about the plan. Most of the men had been worrying about the future of the missionary type of salesman in the grocery field, for the opposition of corporate and voluntary chains to calls by missionary salesmen had for some time seemed to presage the eventual abandonment of that type of selling. Those men, however, who remained after the Larmon Company had reduced its salesforce were then confident that there was a definite place for them in the company's sales program; and they showed increased enthusiasm in their work.

Should the management have made any changes in its program of control for the missionary salesmen?

3. STRENGTH UNION COMPANY

USE OF MISSIONARY SALESMEN

The Strength Union Company manufactured heavy pipe unions[1] of good quality, the patented features of which made them superior for use on steam pipe lines, high-pressure pipe lines, and pipe lines in oil fields. For about 12 years the company had advertised extensively in three trade papers which covered the three principal markets for these unions—the power industry, the oil industry, and the railroads. In addition, it had employed from one to ten missionary salesmen to assist distributors and encourage the use of Strength unions. In 1925 the company considered discontinuing the use of missionary salesmen on the ground that the Strength unions had become so well known that the missionary work was largely wasted effort.

The foundry, machine shop, and sales office of the Strength Union Company were located in New York. Prior to 1910, light as well as heavy unions had been manufactured. Sales of the company had been mostly local; and although the company had placed a trade-mark on its products, that trade-mark had not gained recognition among consumers. The products were sold purely on a price basis in competition with numerous other makes of pipe fittings. About 1910, however, the company started an advertising campaign in a trade paper of national distribution in the power field to exploit patented improvements which the company had made on its unions. This advertising emphasized the patented features of the unions and several other features which differentiated the Strength unions from competing unions. For instance, many of the competing unions required leather or rubber gaskets to keep the joints from leaking; the Strength unions had a ground metal-to-metal ball joint which did not require the use of a gasket or any sealing compound.

Although the company continued, after 1910, to manufacture a few light unions which were sold wholly on a price basis, it specialized in the manufacture of heavy durable pipe unions and a few other steam-fitting specialties, such as flange unions, elbows, and tees. Advertising was directed to engineers, steam fitters, and master plumbers. since those were the individuals who, in most

[1] A pipe union is a device for joining two pieces of pipe.

industrial factories and power stations, specified or requisitioned pipe fittings. Purchasing agents frequently did the actual purchasing, but they usually purchased what the engineers specified.

Through advertising and the use of missionary salesmen the company established a recognition for its products and a reputation for quality which lifted the products out of the strictly price competitive class into a class of specialties which engineers in many instances specified in order to insure lasting and tight-fitting pipe connections.

When the company first started national distribution, it had followed, in general, a policy of selecting supply firms as exclusive distributors. In the oil industry, for example, it had appointed as exclusive distributors two companies which had branches in most of the oil producing centers. To secure distribution of unions for use in power stations, factories, and large buildings, the company in most instances had appointed as exclusive distributor a supply firm in each large city. The steam fitters' and plumbers' supply firms sold to steam-fitting or plumbing contractors and directly to power stations and large industrial concerns such as steel mills. The company usually had four or five regular salesmen who called on the distributors.

In addition to its regular salesmen, the company employed a force of one to ten missionary salesmen. These salesmen called on engineers in the power stations, in industrial factories, and in contracting firms to demonstrate the superior qualities of Strength unions and to induce the engineers to specify these unions for use in their plants. These salesmen also called on steam fitters and master plumbers in large industrial companies and on plumbing and steam-fitting contractors who were customers of the supply firms. The salesmen took orders, which were filled through the local supply firms representing the company. The company had found that the use of these salesmen assisted in introducing Strength unions in many places where the supply firms, with their large line of other products, had not succeeded.

The sales methods of the company had been successful, and sales volume had increased steadily. The company gradually had discontinued its policy of granting exclusive distribution franchises to supply firms and had adopted instead a policy of selling to two or more large distributors in each important city. The Strength unions had become so well known among engineers

and contractors that the company found the use of exclusive distributors limiting its sales volume. Contractors tended to purchase regularly from one supply firm and rarely split their purchases. Executives of the Strength Union Company believed that if Strength products were available through more distributors, contractors would purchase these in preference to competing products.

In 1925 the company was employing one missionary salesman and three salesmen who visited supply firms. The regular salesmen, because of their large territories, were able to call on supply firms only once or twice a year. Orders came in regularly from the supply firms which carried the Strength unions, without personal solicitation by the salesmen. Approximately 60% of the company's sales were on reorders.

The company had added no new features to its products after 1910, and by 1925 other companies were advertising unions for high-pressure pipe lines which were of a quality practically equal to the Strength unions. In 1925 the Strength unions, therefore, were coming to compete more on a price basis than had been the case during their first ten years on the market. For two or three years preceding 1925 the missionary salesmen had reported that in practically every instance the persons on whom they called already were acquainted with Strength unions and their advertised advantages. In the first few years after 1910, the missionary salesmen had turned substantial orders over to local supply firms. By 1924, however, the annual orders secured by a missionary salesman had diminished to a point where they were unimportant.

One official of the Strength Union Company advocated the discontinuing entirely the use of missionary salesmen. The expense of using missionary salesmen had increased threefold over the cost prior to 1917. In 1925 it was necessary to pay one of these salesmen about $50 a week for salary and about $75 a week for traveling expenses. While sales expenses were advancing, the margin of profit gradually was declining because of the increasing competition.

Another official of the company urged that it was a mistake to slacken the sales effort. The regular salesmen, since they called on wholesale supply firms so infrequently, were not in a position to give much sales help to those distributors. In some instances the salesmen called on large users of unions to encourage the use of Strength unions, but they ordinarily did not have the time to

call on the numerous smaller users. Supply firms, because of the large number of items in their lines, ordinarily did not push any one item. Their salesmen acted rather as order takers.

Should the company have discontinued the use of missionary salesmen?

4. McRAE COMPANY

SALESFORCE MANAGEMENT

Early in 1938 the executives of the McRae Company, a paint manufacturing concern, decided to review the activities of the company's salesmen and manufacturers' agents. Although sales volume had increased in 1937 and had been satisfactorily maintained in the first quarter of 1938, the officers believed that the company was not attaining the volume of business which the outstanding characteristics of its products warranted.

The McRae Company made a limited line of specialty paints, which included factory window-glass paints, acid- and caustic-resisting paints, anticorrosion paints, and oil paints for walls and ceilings. Each of these paints had been developed originally to solve special problems of painting for industrial concerns or for paint contractors. Business was divided between these two markets. The officers held the opinion that a small company had little opportunity for profit in entering the paint business unless it made items with unusual characteristics which permitted specialty selling. Therefore the company maintained a laboratory in which it experimented in the development of paint products. New items were not added to the line unless they helped solve painting problems in a more satisfactory manner than any product on the market with which the officers were acquainted. The McRae Company had limited financial resources (see financial data, Exhibit 1).

Since the ultimate purchasers of the company's paints were industrial or commercial buyers, on the one hand, and master painters and paint dealers, on the other, the company sought to use two sets of wholesalers to reach these markets. The officers planned to have one mill supply firm and one paint wholesaler in

each important city. In large metropolitan districts[1] more than one mill supply firm or paint wholesaler frequently was used. In 1938 the company was seeking to establish more outlets throughout the United States. Salesmen or manufacturers' agents negotiated most of the sales to wholesalers and did missionary selling to con-

EXHIBIT 1
MCRAE COMPANY
Financial Data

Operating Statement, 1937

Net Sales		$169,000
Gross Margin		78,000
Expenses:		
Salaries of Officers	$10,400	
Sales Commissions	15,208	
Traveling	6,240	
Advertising and Sales Promotion	12,000	
Office	10,400	
Other	6,358	60,606
Net Profit		$ 17,394

Balance Sheet, January 1, 1938

Assets		Liabilities	
Cash	$ 1,300	Accounts Payable	$20,800
Accounts Receivable	26,000	Loans by Officers	6,500
Securities	5,200	Capital and Surplus	19,890
Advertising Materials	2,730		
Trade-marks	2,600		
Advances to Salesmen	4,290		
Equipment and Supplies	5,070		
Total Assets	$47,190	Total Liabilities	$47,190

tractors and industrial users in order to help the wholesalers develop a market. A comparison of total sales in Exhibit 1 with sales by salesmen in Exhibit 4 indicates, however, that the company sold some merchandise without the use of salesmen. These latter sales for the most part were sales made direct by the officers or by mail to mill supply firms or paint wholesalers in territories where the company did not have resident salesmen. In spite of the general policy of using wholesalers exclusively, the company occasionally, when it was developing a new territory, made direct sales to industrial users or to paint dealers. After a wholesaler had been established in a territory, it was expected that all users

[1] Boston, New York, Buffalo, Philadelphia, Pittsburgh, Cincinnati, Cleveland, Chicago, Detroit, St. Louis, Los Angeles, San Francisco.

would buy from the wholesaler. Although the company paid its salesmen a higher commission on direct sales to industrial users or to dealers than on sales to wholesalers, it did not intend to encourage salesmen to make such sales. These transactions required the approval of the officers.

For its particular products the McRae Company considered that the small paint wholesalers constituted a better channel of distribution than the large concerns. The small wholesaler was thought to be eager to handle the McRae Company line because certain advantages of these products gave him a basis for approaching large paint contractors. Nevertheless, the company sought some large firms as distributors for the prestige value attached to having the better-known wholesalers as representatives.

The results of the company's sales policy are illustrated by Exhibit 2. In this part of New England the officers found it difficult to obtain and retain wholesalers. For instance, 7 of the 45 firms bought sample lots only. Twelve of the firms, classified as large, discontinued buying within a year, in contrast to only one small firm that stopped purchasing.

The McRae Company published list prices for its products; a typical scale is shown in Exhibit 3. The company tried to maintain prices and refused to sell to wholesalers who consistently varied prices through changes in discounts. The company expected mill supply firms to give industrial concerns 25% off list; paint wholesalers were to allow paint contractors 25% off list and paint dealers 33⅓% off list. The company granted discounts of 33⅓% and 25% off list.

To assist in the sale of its products the McRae Company used both space advertising and direct-mail material sent out under the name of the wholesaler to the individual buyers or paint contractors. The total budget for advertising and sales promotional material was $12,000 in 1937. To reach the paint contractors and architects, the company advertised in the monthly magazines *Practical Builder* and *National Painter's Magazine*. In *Practical Builder* the company had a one-ninth page insertion twelve times a year at a cost of $98.50 each issue. The company used a half-page advertisement in *National Painter's Magazine* at a cost of $200 each for twelve insertions. The McRae Company also had several pages at a cost of $350 in *Painters' Price Guide*, which was sent annually to all master painters, and an insertion at $280 in

EXHIBIT 2
McRAE COMPANY
Sales to Customers, 1936 and 1937
(Selected Area)

Customer Number*	Location	Class†	Sales 1936	Sales 1937
1	Bridgeport	S	$101.60	$ 241.54
2	Hartford	L	906.28	393.90
3	Hartford	L	368.46	713.93
4	Hartford	L	53.62	
5	Hartford	L	5.52	
6	New Britain	L	143.47	
7	New Haven	L	30.48	
8	New London	Sample lot	7.67	
9	Norwich	Sample lot	22.36	
10	Putnam	Sample lot	....	29.83
11	Thompsonville	Sample lot	10.20	
12	Waterbury	L	....	2,699.06
13	Waterbury	L	53.63	
14	Newport	L	198.96	
15	Pawtucket	Paint contractor	....	5.85
16	Providence	S	....	204.20
17	Providence	Retail store	....	18.53
18	Providence	L	....	677.92
19	Woonsocket	S	133.25	209.11
20	Woonsocket	Retail store	....	23.40
21	New Bedford	Retail store	18.53	
22	New Britain	L	$323.83	$ 644.02
23	New Haven	L	139.71	
24	New Haven	Poor credit	44.42	
25	New London	M	35.10	34.91
26	New London	M	46.32	92.17
27	Norwich	L	12.02	32.21
28	Waterbury	Sample lot	....	7.67
29	Willimantic	S	289.12	132.29
30	Pawtucket	S	8.45	2,463.57
31	Pawtucket	L	393.18	980.55
32	East Providence	S	....	19.66
33	Providence	L	184.24	10.92
34	Providence	L	119.17	
35	Providence	S	....	15.09
36	Providence	S	....	30.19
37	Providence	L	46.15	
38	Woonsocket	L	80.51	
39	Woonsocket	S	292.57	819.42
40	Attleboro	S	192.74	
41	Fall River	L	75.79	
42	Fall River	Sample lot	8.05	
43	New Bedford	Sample lot	20.93	
44	New Bedford	L	57.20	
45	New Bedford	S	....	246.02

* Customers 1–21 were paint wholesalers; Customers 22–45 were mill supply wholesalers.
† Class: Large, Medium, Small.

Master Painters' Handbook, distributed every two years to large paint contractors. The company had one page in the architectural section of *Sweet's Catalog* and one in each of the industrial volumes, at a total cost of $500 annually. To advertise its products in the industrial market, the company used one-ninth of a page, twelve times a year, in *Industrial Equipment News* at a cost of $79 each issue. The remainder of the advertising and sales promotional expenditure, which amounted to approximately half the total, covered the costs of color cards, samples, display signs and racks, folders, special fliers and leaflets, catalogue sheets for wholesalers' salesmen, and costs of direct-mail advertising.

EXHIBIT 3
MCRAE COMPANY
List Price Schedule for Selected Product

30-gallon Drum, per Gallon	$3.00
5-gallon Drum, per Gallon	3.05
1-gallon Can (4 to a carton), Each	3.15
Quarts (12 to a carton), Each	0.95
Pints (12 to a carton), Each	0.60

The company sought to assist the wholesalers in the promotion of its products with ultimate users. In order to have detailed information about users and their needs, the company furnished wholesalers' salesmen with questionnaires on which specific data concerning a customer and his requirements, such as name and address, full data on surface to be painted, kind of paint previously used, finish desired, condition of existing surface, and any unusual conditions, were to be noted. On the basis of this information the company sent letters of advice on specific problems, as well as standardized direct-mail advertising material.

Salesmen and manufacturers' agents were employed to sell to both paint wholesalers and mill supply firms and to secure new outlets where the company was not represented. With the exception of a few representatives who served as district managers, the salesmen and manufacturers' agents worked entirely on a commission basis. Commission arrangements with the men varied with conditions. In general, however, salesmen who sold only the McRae Company products received 15% on net sales to wholesalers, 25% on sales to industrial concerns direct, and 20% on sales to dealers. When the salesman was in fact a manufacturers' agent and sold other products, he was allowed 10% on the McRae Company line. In territories where there was a district manager,

EXHIBIT 4

MCRAE COMPANY

Territorial Assignments, Sales, and Commissions of Salesmen, 1936 and 1937

Territory	Salesman Number*	Number of Months Employed		Sales		Commissions	
		1936	1937	1936	1937	1936	1937
Maine and New Hampshire	1 (Ind)	1	..	$ 23.63	....	$ 4.73	
	2 (Paint)	4	12	394.76	$ 2,231.48	55.94	$ 487.71
Eastern Massachusetts	3	4	1	2,043.04	328.28	204.31	32.82
	4	7	9	1,083.13	2,562.64	162.47	295.85
	5	5	..	1,042.16	....	125.71	
	6	4	..	1,307.15	....	136.29	
	7	1	..	221.44	....	22.14	
	8	..	1	....	12.68	....	2.53
	9	..	2	....	158.31	....	38.44
	10	..	1	....	159.42	....	15.94
Western Massachusetts	11	12	3	5,526.33	996.98	588.01	160.47
	12	..	7	....	2,853.86	....	334.65
Rhode Island and Connecticut	13 (Ind)	12	8	2,495.48	1,008.46	254.93	103.43
	14	12	2	1,662.97	231.43	352.14	36.95
	15	..	10	....	8,765.73	....	1,300.22
New York City	16 (Ind)	12	12	6,419.84	5,768.09	1,699.06†	879.75
	17 (Sub)	5	7	778.30	420.16	78.42	44.23
	18 (Sub)	..	3	....	165.88	....	8.79
	19 (Sub)	2	..	442.05	....	44.20	
	20 (Sub)	..	1	....	297.34	....	44.60
	21 (Sub)	..	4	....	372.19	....	39.87
	22 (Paint)	..	1	....	161.72	....	22.62

EXHIBIT 4 (*Continued*)

Territory	Salesman Number*	Number of Months Employed 1936	Number of Months Employed 1937	Sales 1936	Sales 1937	Commissions 1936	Commissions 1937
Northern New Jersey	23	..	..	$ 1,733.73	....	$ 187.74	
	24	..	1	....	$ 101.97	....	$ 14.00
Southern New Jersey and Eastern Pennsylvania	25 (Sub)	12	3	989.13	332.71	100.74	36.69
	26‡	12	12	12,644.92	6,527.38	1,472.20	949.21
	27 (Sub)	..	4	....	2,338.70	....	273.99
	28 (Sub)	3	..	146.28	....	21.68	
	29 (Sub)	..	10	....	3,165.80	....	381.86
	30 (Sub)	..	3	....	366.43	....	3.98
Eastern New York	31	6	12	1,067.02	2,398.03	114.37	271.32
Western New York	32	8	7	1,118.57	1,232.60	140.84	128.99
	33	..	4	....	2,997.84	....	303.56
Western Pennsylvania and West Virginia	34 (Ind)	12	8	2,368.72	1,117.71	232.49	111.70
	35 (Paint)	3	12	1,067.17	3,602.04	107.06	364.44
Northern Ohio	36 (Ind)	11	..	963.55	....	104.77	
	37 (Paint)	..	11	....	2,580.28	....	259.25
Southern Ohio, Northern Kentucky, and Eastern Indiana	38	12	12	11,382.94	9,112.40	1,143.45	930.79
Detroit and Eastern Michigan, Toledo	39	12	12	6,338.32	5,514.65	633.83	552.76
Western Michigan	40	12	..	546.95	....	71.98	
	41	12	9	3,867.81	1,618.92	459.86	184.82
Western Indiana, Northern Illinois, and Southern Wisconsin, Chicago	42 (Ind)	12	12	6,914.61	2,025.78	754.34	280.11
	43 (Sub)	12	10	898.75	876.53	89.88	74.56
	44 (Sub)	..	3	....	220.79	....	31.43
Northern Wisconsin, Northern Illinois and Southern Wisconsin, Chicago	45 (Paint)	..	4	....	397.81	....	60.58
	46	1	2	126.68	102.83	12.68	10.28
	47	..	5	....	1,437.40	....	215.62

EXHIBIT 4 (*Continued*)

Territory	Salesman Number*	Number of Months Employed		Sales		Commissions	
		1936	1937	1936	1937	1936	1937
Eastern Missouri	48	12	3	$ 1,995.41	$ 525.82	$ 360.10	$ 52.58
	49	..	5	....	3,370.74	....	273.60
Western Missouri	50	12	7	2,315.59	485.72	233.86	45.10
Kansas	No salesmen						
Florida	51	..	4	....	2,046.37	....	178.63
Virginia	52	11	..	755.34	....	76.26	
	53	..	10	....	232.49	....	23.56
North and South Carolina	No salesmen						
Georgia	54	7	12	4,424.29	7,560.71	443.56	764.49
Louisiana and Mississippi	55	12	12	1,767.66	4,531.15	253.71	471.18
	56	1	..	120.06	....	18.01	
Texas and Oklahoma	57	2	..	156.00	....	15.61	
	58	3	..	931.15	....	107.61	
	59	1	..	1,083.61	....	108.36	
	60	..	2	....	176.74	....	17.68
Alabama	No salesmen						
Arkansas and Tennessee	61‡	..	6	....	18,478.73	....	2,479.12
	62 (Sub)	..	3	....	174.97	....	18.30
	63 (Sub)	..	7	....	759.10	....	76.26
Mountain Area, Denver, Colorado, Western Nebraska, Wyoming, and New Mexico	No salesmen						
Nebraska	64 (Spec)	1	..	193.35	....	19.33	
	65	3	6	930.54	695.49	93.05	69.12
Salt Lake City Area	No salesmen						
Southern California	66	12	12	4,992.59	3,771.65	782.07	567.87
Northwest Area	67	..	9	....	1,521.04	....	230.70

EXHIBIT 4 (*Continued*)

Territory	Salesman Number*	Number of Months Employed		Sales		Commissions	
		1936	1937	1936	1937	1936	1937
Montana	No salesmen						
Western Canada	68	..	9	....	$ 967.37	....	$ 96.73
Ontario	69	..	10	....	622.54	....	62.26
	70 (Sub)	12	5	$ 836.17	287.20	$ 130.91	36.13
	71 (Spec)	6	..	261.57	....	30.91	
	72 (Spec)	..	5	....	495.34	....	27.19
	73 (Spec)	..	3	....	216.61	....	29.38
	74 (Sub)	1	..	63.01	....	9.45	
	75 (Spec)	1	..	43.94	....	4.39	
	76 (Spec)	3	..	123.83	....	12.39	
	77 (Spec)	3	12	142.14	373.41	28.43	74.70
	78 (Spec)	10	3	1,458.63	395.20	204.07	53.82
	79	1	..	12.63	....	1.90	
Miscellaneous	80	10	12	339.60	175.80	49.78	14.99
	81	..	3	....	291.89	....	29.20
	82 (Spec)	2	..	88.47	....	35.39	
	83	..	1	....	11.37	....	2.30
	84 (Spec)	..	1	....	348.57	....	46.70
	85 (Spec)	..	2	....	412.33	....	43.80
	86 (Spec)	..	3	....	639.54	....	101.24
	87 (Spec)	..	1	....	160.07	....	24.01
	88	..	1	....	33.14	....	6.11
	89	..	1	....	13.91	....	2.78
	90	4	..	248.09	....	30.13	
	91	1	..	6.55	....	0.99	
Total Sales and Commissions by Salesmen	....	..	..	$98,905.65	$124,338.26	$12,426.53	$15,208.34

* "Ind" indicates that this salesman sold only to mill supply firms and their customers; "Paint" shows that he sold only to the paint wholesalers, dealers, or contractors; "Sub" means that he was employed by another salesman or agent and not by the company; "Spec" indicates a specialty salesman who had contacts with certain accounts but was not regularly employed by the company.

† Includes salary, $1,014, in first six months.

‡ District sales manager.

salesmen received 10% on their sales and the district manager 5% on these sales. Salesmen or agents did not receive special compensation for missionary work.

In working with wholesalers, salesmen and agents were supposed to outline a plan of sales campaign with each wholesaler, check his stock if he already handled the McRae Company line, and see that he was supplied with dealer aids; they were expected to call on him regularly twice a month. On missionary work the officers of the McRae Company did not have their salesmen travel the regular route of wholesalers' salesmen. The procedure, rather, was to have the wholesaler select five or six of his best prospective customers and to see that the McRae Company salesmen called on these prospective customers. The wholesaler's salesmen frequently were rerouted so that they could be with the salesmen of the McRae Company.

Territorial assignments of salesmen varied greatly. Changes in territories were made as experience seemed to indicate a better arrangement. Territorial assignments, sales, and commissions for the years 1936 and 1937 were as shown in Exhibit 4.

In 1938 the company had only six full-time salesmen, numbers 9, 11, 15, 22, 33, and 61. Numbers 9, 22, and 33 had been employed late in 1937. Number 11 formerly had worked part time for the company; beginning in January, 1938, he became a full-time salesman. Number 61 was the southern district manager. Nearly all manufacturers' agents carried lines of standard paints which supplemented the specialty items of the McRae Company. Other lines were also handled by some agents. For instance, number 38 sold gaskets and a cleaning compound; number 39, a brand of key paste; number 26, key paste, cordage, and a paint-spraying machine; number 2, Insulite wallboard; and number 37, varnishes and enamels. Manufacturers' agents, such as number 38 and number 26, earned from one-fourth to one-third of their total income on McRae products. One manufacturers' agent, number 26, was also a district sales manager. There were numerous reasons why salesmen or agents left the company. Frequently men were hired by mail and were allowed to demonstrate what they could do. Some men quit because of their inability to make sales, whereas others were dropped as soon as one of the officers had interviewed them in the field and had determined that they were not suitable types.

The company did not exercise any rigid or formal control over its salesforce. For instance, it did not require reports as to firms called on or the number of visits actually made. It was the conviction of the officers that the men should be responsible and able to manage themselves. The officers wanted to have men who had confidence in their ability to earn on a straight commission basis. This type of person would wish to be independent and, in the opinion of the officers, would not react well to rigid control.

The officers, on the other hand, did try to cooperate fully with the salesmen in an attempt to make sales effort more effective. One of the officers, for example, usually went with new representatives on their first calls on wholesalers. Lists of prospective wholesalers, dealers, and industrial concerns were sent out from the main office. In the event of complaints about the products, the officers assisted in determining the difficulty and making the necessary adjustment. They provided salesmen with aids, such as promotional materials, color cards, and architects' folders containing specifications for the use of the paints. The officers wrote salesmen and agents regularly, and usually interviewed them at least twice a year.

What action should the executives of the McRae Company have taken as a result of their review of the activities of the salesmen and manufacturers' agents?

5. GLENROCK MANUFACTURING COMPANY

METHOD OF PAYING SALESFORCE

In 1921 the sales of the Glenrock Manufacturing Company, like the sales of most other industrial enterprises, fell off sharply. The company, which manufactured heating equipment, introduced various economies in operation and in October, 1921, announced a 12½% reduction in the wages and salaries of all employees and officers. This reduction in salaries applied, of course, to the salesforce. Since the task of securing orders in a strongly competitive market placed a heavy burden on the salesforce, the president of the company called in a consultant to advise him regarding changes in methods of compensating salesmen and also regarding

other sales problems. The first conference with the consultant was held at the company's office in Chicago on November 22, 1921. The consultant was asked to make recommendations on methods of paying salesmen to go into effect on January 1, 1922; and his report was called for on December 9.

During the time at his disposal the consultant obtained the following facts regarding the company's affairs. The company manufactured boilers, heaters, radiators, and other heating equipment used in office buildings, schools, other public buildings, and private dwellings. The company operated several sales branches. In its Chicago district it employed 35 salesmen, and in the Cleveland district 19 salesmen. The number of salesmen in the other districts varied with local conditions. The salesmen were paid straight salaries, and were reimbursed for actual expenses incurred. The salesmen generally received salaries of $2,000 to $2,500 a year, but the company frequently lost salesmen to competitors who offered higher salaries, and the market rate for men of the type desired was judged to be $3,000 to $3,800. The average size of order obtained by salesmen was between $100 and $150, and the maximum order was about $12,000.

The company made 60% of its sales to wholesalers, who resold mostly to contractors for installations in large buildings. About 40% of sales were made direct to retailers. Extensive advertising was carried on among retailers, contractors, architects, and consumers in the districts in which sales branches were located. Sales to several large wholesalers were made by the company at headquarters. A few salesmen specialized on missionary work with architects. The bulk of the work of the general salesforce, however, was with the smaller wholesalers, retailers, contractors, and building owners. The retailers who handled the company's products were largely plumbers and steam fitters. The company's sales showed great seasonal fluctuations, because of the seasonal character of the building industry.

In securing orders for large contracts, two or more salesmen occasionally had to cooperate, when, for example, the owner was located in one city and the retailer or contractor in another. In compiling sales records for individual salesmen the company sought to divide the credit for such cooperative orders equitably among the salesmen concerned. When a retailer bought from a wholesaler, the sale was credited, on the salesmen's records, to

the salesman in whose territory the retailer was located, provided the facts were reported to the company.

The company had not made an analysis of its market for the purpose of setting up sales quotas. No system of customers' records was maintained in the sales department. Although the company had a record of each salesman's monthly sales, it had not computed the ratio of salary to sales for each salesman.

From the data available, the consultant computed the ratios of salesmen's salaries to sales in 1920 in the Chicago and Cleveland districts. The figures for the Cleveland district were higher than those for the Chicago district, but the latter were judged to be the more typical of conditions in other districts. In a few instances the differences in ratios could be accounted for by territorial differences, but most of the outstanding contrasts apparently could not be explained in that way. The executives were greatly surprised, for example, to learn that one salesman, who had a good territory and who was rated in their opinion as an especially good salesman, was receiving a salary that amounted to 6.3% of his sales.

EXHIBIT 1
GLENROCK MANUFACTURING COMPANY
Ratio of Salesmen's Salaries to Sales in the Chicago District in 1920*

A	1.4%	H	3.3%	O	2.7%	V	2.8%	CC	0.7%
B	2.2	I	3.5	P	6.3	W	2.4	DD	1.8
C	4.0	J	3.4	Q	2.6	X	2.3	EE	1.0
D	1.9	K	1.8	R	3.8	Y	2.3	FF	1.0
E	4.5	L	3.1	S	2.9	Z	3.1	GG	0.8
F	3.1	M	1.6	T	2.2	AA	1.06	HH	0.9
G	2.6	N	3.1	U	4.5	BB	2.5	II	1.06

* Salesmen A–Z were country salesmen; Salesmen AA–II were city salesmen.

EXHIBIT 2
GLENROCK MANUFACTURING COMPANY
Ratio of Salesmen's Salaries to Sales in the Cleveland District in 1920*

A	0.7%	F	4.8%	K	3.0%	P	3.1%
B	1.6	G	5.0	L	3.2	Q	2.8
C	2.6	H	5.8	M	2.1	R	3.4
D	3.2	I	5.1	N	5.1	S	3.2
E	3.3	J	3.8	O	4.1		

* Salesman A was a city salesman, and the others were country or suburban salesmen.

For the Chicago district the figures for individual salesmen were as shown in Exhibit 1. For the Cleveland district the ratios are given in Exhibit 2.

As a result of these analyses and a consideration of general information regarding the company and business conditions, the consultant submitted a report on December 9, 1921, from which the following excerpts are taken.

Recommendations on Methods of Paying Territory Salesmen in the Year 1922

1. For the year 1922, each salesman should be guaranteed a monthly salary, provided he remains in the employ of the Glenrock Manufacturing Company, at least equal to the monthly salary received in December, 1921.

2. The following increases in salary should be made:

a. In *city* districts, the guaranteed annual salary of a salesman should be made equal to 1% of his average annual sales 1919–1921 in any case in which the guaranteed salary otherwise would fall below that amount;

b. In *suburban* and *country* districts, the guaranteed annual salary of a salesman should be made equal to 1.5% of the average annual sales in any case where the guaranteed salary otherwise would fall below that amount.

3. In addition to guaranteed salary, in 1922 a bonus should be paid monthly to each salesman whose total sales exceed his monthly quota. The bonus should be 2% of the amount by which the sales exceed the quota for the month.

4. In the year 1922 the quota for each salesman for each month should be his average sales (in dollars) for the corresponding month in the three-year period 1919–1921, with the following exceptions:

a. In *city* districts, if the guaranteed annual salary of a salesman is in excess of 1.25% of his average annual sales, his annual quota should be 80 times his guaranteed salary. This annual quota should be divided into monthly quotas in accordance with the normal seasonal variations;

b. In *suburban* districts, if the guaranteed annual salary of a salesman is in excess of 2.5% of his average annual sales, his annual quota should be fixed at an amount equal to 40 times his annual salary, the monthly quotas to be adjusted for seasonal variations;

c. In *country* districts, if the guaranteed annual salary of a salesman is in excess of 3% of his average annual sales, the annual quota should be 33⅓ times his guaranteed salary, with adjustments of monthly quotas for seasonal variations;

d. If in any particular case an abnormally large or an abnormally small monthly quota would result from the use of the method of three-year monthly averages, as, for example, in a case where an exceptionally

large order had been shipped in one month, the quota should be adjusted by averaging three consecutive months for the three-year period, setting up one-third of the three-month average as the quota for each of the three months;

e. Subject to the preceding provisions, where two or more territories have been consolidated under one salesman in 1920–1921, the quota should be based on the record of the salesman, not on the combined records of the territories consolidated;

f. In any instance where a salesman has been transferred from one territory to another, however, within the three-year period, his quota should be made up from the records of the territory in which he now works rather than from his personal record in another territory;

g. When a new salesman is hired, a reasonable quota should be established for him, basing it on the past records of his territory and on the rate of salary that is guaranteed to him; his annual quota in a suburban or country district should be at least 40 times his salary and in a city district at least 80 times his salary.

5. Each salesman should be expected at least to reach his quota each month.

If any territory is not capable of yielding, in a normal year, a volume of sales at least equal to the quota established, the territory should be enlarged or some other means found to bring the salesforce expense for the territory within economical limits.

If a salesman who has been given ample opportunity and who has received proper instruction and assistance cannot reach his quota regularly in a territory that is capable of yielding the assigned quota, he should be replaced.

6. Each sale should be credited to the record of the salesman who makes the sale to the initial purchaser. A mail order should be credited to the record of the salesman who regularly calls on the customer sending in the order.

When an identified sale is made to a wholesaler for shipment outside the territory of the salesman in which the wholesaler's place of business is located, the credit for the sale should be split between the salesman in the territory in which the wholesaler is located and the salesman in the territory in which the shipment is delivered. When an unidentified sale is made to a wholesaler, the sale should be credited to the salesman who regularly sells to the wholesaler.

When a sale is made to a contractor for shipment to an outside territory, the credit for the sale should be split between the salesman who sells to the contractor and the salesman in the territory in which delivery is made.

A salesman who influences a sale in which another salesman participates should be given the right to file a claim with the branch manager for a share in the credit for the sale.

The branch manager should be granted full discretionary power to make such adjustments as may seem to him to be fair in allocating credit for sales.

7. A careful study should be made of salesmen's routes and order of calls, in order to assist them in saving time and expense.

8. The card record of customers should be used systematically to prevent the loss of customers. As soon as an account appears to be becoming inactive, the salesman in the territory should be asked to explain the reason, and a personal letter should be written to the customer. If this does not bring an order, the customer should be visited by the assistant branch manager or by a missionary salesman.

A similar procedure should be followed in the case of any customer from whom the company has reason to believe that it is not receiving as large a volume of orders as the customer's general standing warrants.

9. An analysis should be made immediately of the potential market in each territory. This should include a list of prospective customers (dealers), to be followed up in practically the same manner that retrogressing accounts are followed up, using missionary salesmen when necessary to secure adequate increase in distribution.

The analysis should also include such general indices as the number of dwellings, new building (in cities), crop conditions, and other indices of market conditions in the territory.

This analysis should include all the data that ordinarily would be used in fixing a quota; instead of using the results of the analysis as the basis of compensation at the present time, however, they should be utilized by the branch manager, or his assistant, in readjusting territories and especially in conferring with salesmen to show them their opportunitites for earning a bonus.

REMARKS

The object of these recommendations is to provide a simple, constructive plan, easily understood by the salesmen, so definite that there will be no occasion for misunderstanding, and approximated to reasonable cost figures. It also is intended to be sufficiently flexible so that in future years it can be modified without embarrassment.

The plan is by no means perfect. It does not provide specific rewards for economy in traveling expenses, for securing new accounts, for stimulating sales of individual products in preference to other products, or for promotional work with consumers and architects. It also does not provide specifically for systematic promotion of salesmen in accordance with merit. These points, and probably numerous others, all are worthy of careful consideration; but in each case they involve obstacles and complications which make it appear inadvisable to attempt to cover them in the plan that is to go into effect January 1, 1922.

The recommendations for increases in salaries involve several thousand dollars' additional expense. This additional expense should be more than offset by the saving on increased sales, without extra expense, that eventually will result from raising the quotas of the least efficient salesmen. In the Chicago branch, using the 1920 figures, for example, the additional expense from increased salaries would be

$3,574. The quotas for the least efficient salesmen, on the other hand, would call for an increase in sales amounting to $372,000, without additional compensation to the salesmen for whom these higher quotas were fixed. The increases in salaries will take care of some cases of especially capable salesmen who deserve larger incomes.

The figure of 1% for city salesmen was d termined from an examination of the Chicago figures for 1920. In that year three of the Chicago city salesmen received salaries of less than 1% of their sales, whereas two had 1% and four had over 1%, the highest being 2.5%. In Cleveland in 1920 the salary of the city salesman was 0.7% of his sales. Possibly the figure of 1% may be too high a guaranty in some individual cases, but it appears fair in its application to the Chicago and Cleveland forces.

The figure of 1.5% for suburban and country salesmen was determined from the 1920 figures for the Chicago and Cleveland branches. On the basis of these figures, it would involve increases in salary for one salesman in the Chicago district and for none in the Cleveland district.

THE BONUS

The 2% rate affords an opportunity for a salesman to obtain a substantial increase in earnings by diligence and good salesmanship. In all cases for which data have been available, except that of city salesmen, the total salesforce expense, including salaries, commissions, and traveling expenses, is substantially more than 2% of sales; hence, there will be a saving to the company as well as a benefit to the salesman by fixing the rate at 2%. To put the rate higher would establish a precedent that later might prove embarrassing and would necessitate setting a higher and consequently a more difficult quota for numerous salesmen. Inasmuch as the bonus is paid on a monthly basis, the risk of abnormally large bonuses being paid in exceptional months would be greater if the rate were higher.

No provision is made for penalizing directly a salesman who fails to make his quota in any one month. It would be possible to stipulate that a bonus should be paid only when the quota in previous months has been met, or to pay the bonus on the amount by which the monthly sales exceed the sum of the quota for the current month plus any accumulated deficiency of quotas in preceding months. Such a provision is not recommended since a salesman cannot control the time of shipment from the factory, although his sales are credited only when shipped.

What action should the management have taken?

6. HAWTHORNE COMPANY

COST OF LIVING BONUS

In the fall of 1941, Mr. Creel, the personnel superintendent of the Hawthorne Company, presented to the executives a plan for a "cost of living bonus" to be paid for the duration of the emergency to all employees of the company whose salaries were less than $75 weekly.

The Hawthorne Company was one of the largest department stores in its city and was recognized as a leader in personnel relations. The management of the company had always been on excellent terms with the employees. Most of the employees were members of the Hawthorne Employees' Association, an independent union formed in September, 1937. This association was an outgrowth of a company union which had been in existence since 1921.

The following excerpt from the November, 1937, contract between the Employees' Association and the management sets forth the general understanding with respect to wage standards:

> With the understanding that minimum wages are stated as a guide for hiring new persons and transferring employees to new positions, the employer intends that minimum rates shall not be considered as standard rates. The minimum wage to be paid to full-time salespeople shall be $15, exclusive of commission. Full-time nonselling employees shall be paid not less than $14, but those who have had one year's experience and have reached the age of 19, shall receive not less than $15. The minimum hourly rate for short-time employees shall in no case be less than the minimum full-time wage divided by the number of hours per week for the job. It is understood, however, that these rates do not apply to Cooperative Students, who may be engaged under agreements with the School Department complying with the minimum wage laws. The employer will continue to keep informed of wage levels in competing stores and in similar jobs in other occupations and endeavor to pay at all times at least as much, other working conditions being equal, as is paid elsewhere.
>
> The employer agrees to classify jobs and to assign standard wages for each, as far as is practicable, including plans for step-rate increases in all classifications which are adaptable to it. It is agreed that in reviewing wages, in hiring new persons, and in transferring employees to jobs, the employer will adhere to standard wage schedules, as recorded on June 1, 1937, and modified by subsequent agreement with the Association or with groups of employees. When an employee works on two or more job classifications carrying different wage

schedules, the wage for his combination job shall be taken as intermediate between the several applicable schedules, weight being given to each wage schedule in proportion to the amount of time assigned out of the total week to each job.

The Hawthorne Company paid an average weekly selling wage, including commissions, of $22, while the average weekly nonselling wage was only slightly lower at $21. These averages were higher, in most instances, than the average wages paid by other stores in the city.

The plan which Mr. Creel presented called for a bonus payment to fluctuate with the cost of living index (see Exhibit 1). It was his opinion that, in view of the rising costs of living, employees of the company were being unduly penalized by a curtailment of

EXHIBIT 1

COST OF LIVING INDEX FOR THE UNITED STATES AND FOR THE CITY IN WHICH THE HAWTHORNE COMPANY WAS LOCATED, FOR SELECTED MONTHS, 1937–1941

(1935–1939 = 100)

	U.S.	City		U.S.	City		U.S.	City
1937			1939			1941		
March....	101.8	101.5	March....	99.1	98.1	Jan.......	100.8	99.2
June.....	102.8	102.6	June......	98.6	97.4	Feb.......	100.8	99.2
Sept......	104.3	104.8	Sept......	100.6	99.3	March....	101.2	99.5
Dec......	103.0	102.2	Dec......	99.6	97.9	April.....	102.2	100.6
1938			1940			May......	102.9	101.1
March....	100.9	99.8	March....	99.8	99.2	June......	104.6	102.5
June.....	100.9	99.8	June......	100.5	100.0	July......	105.2	103.7
Sept......	100.7	99.8	Sept......	100.4	99.4	Aug......	106.0	103.8
Dec......	100.2	99.8	Dec......	100.7	99.0			

Source: U.S. Bureau of Labor Statistics, *Monthly Labor Review* (Washington, the Bureau).

their purchasing power; and he pointed out that in some parts of the country the failure of stores to recognize the need for some sort of wage adjustment plan had caused serious union difficulties. *Women's Wear Daily*[1] had reported the retail employment situation as follows:

[In several sections of the country] the emergency-born personnel troubles have continued to beset retail employers and have taxed their ability to keep their personnel rolls sufficiently up-to-date and the quality of their help at a reasonably high standard.

[1] September 9, 1941, p. 31.

Hardest hit in the various brackets of personnel in stores have been the nonselling groups. However, the selling brackets also have suffered and continue to suffer. The immediate result of the chief difficulties, to wit, the retailers' inability to compete with industrial employers in inducements to employees, such as a shorter work week and better pay, has been a very rapid turnover of help. Although accurate figures are not available in the stores, the turnover of help is reported to be inconveniently high. One of the adverse effects of the high turnover has been the deficiency in training and, therefore, service to the store and to the public. This, it appears, is felt in the service departments as well as on the selling floor.

Among the retail stores it is found that the greatest difficulties are experienced by the larger stores. Specialty shops report that the increase of turnover in selling groups is negligible. But inasmuch as approximately 60 per cent of their help is in the nonselling brackets and the turnover there shows a marked increase the operation as a whole has been impaired.

Mr. Creel did not mean to imply that his plan would put the store on a wage basis comparable to those of industrial concerns. But he did believe that the plan would anticipate and eliminate some of the difficulties that were currently being encountered in many stores. His memorandum to the executives read in part as follows:

The Cost of Living Index in this state on the new 1935 to 1939 base stood at 99.3 on the first of January [1941] and was lower than at any time in the preceding four years. It had risen to 103.9 in June, 104.6 by July. I propose that when it reaches 105, separate monthly checks marked "Cost of Living Bonus" shall become payable to all regular employees with salaries under $75 weekly. The formula might be as follows: When the monthly index is reported during the following month, checks are to be made payable at the end of the latter month, the bonus being 5% when the index is between 5 and 10, with the understanding that if it goes above 10, there will be a reconsideration of the plan, and that if it goes below 5, the Management will determine on the basis of other facts, such as sales volume and profit, whether the bonus plan shall be continued or adjusted downward.

Each check should be a straight percentage of total wages paid during the preceding month, including salary, overtime, commissions, premiums of any sort, in other words, a payment of 5% of the cash dollars received by each employee for the month. It will be a fairer plan than a graduated percentage for various wage groups.

Although Mr. Creel's plan was the first of its kind in the city, similar plans had been introduced in other sections of the country. Two of these plans had been described in *Women's Wear Daily* as follows:

PITTSBURGH MERCANTILE COMPANY[1]

The Pittsburgh Mercantile Company which operates 10 stores in Pittsburgh and Aliquippa and which introduced a Cost of Living Income Adjustment Plan on Aug. 1, 1941, reported that, so far as it can judge, the plan has been found satisfactory to the employees as well as to the firm.

Taking no credit for originating the scheme, the Pittsburgh Mercantile Company said it patterned its plan after that of Wolf & Dessauer, Fort Wayne, Ind. A booklet explaining the system in detail was distributed to employees.

The Cost of Living Income Adjustment Plan applies to all regular and extra employees, except executives, major buyers, and outside salesmen; and this extra compensation, based on changes in the Cost of Living Index compiled by the Bureau of Labor Statistics of the United States Department of Labor and the Cost of Living Index for Greater Pittsburgh compiled by the Research Bureau of the University of Pittsburgh, is to be adjusted every three months.

The extra compensation is paid at the rate of 1 per cent of the Basic Weekly Wage for each point of change above 100 in the aforementioned Cost of Living Indices, with a maximum of 10 per cent increase adjustment. It has not been decided yet what will be done if the increase goes beyond 10 per cent. Should the Cost of Living Indices decrease, a downward adjustment will be made, but it was noted in the plan that "in no case will any present basic wage be reduced under this plan."

R. H. Gilmore, superintendent of the Pittsburgh Mercantile stores, in discussing the Cost of Living Plan, noted that the plan applies to the basic wage and not to any overtime. He revealed that there are approximately 1,000 regular employees in their stores. He emphasized the fact that the new plan has definitely not taken the place of regular wage increases, and that the policy of the Pittsburgh Mercantile stores is to review salaries at least twice a year, and in times such as the present, more often.

It was pointed out by this executive that the only objection to the Cost of Living Plan is that it is unfair "because the living cost will increase faster than profits," and that therefore it is unsound to pay wages on the basis of the increased cost of living; for it was noted, "you have to make money before you can give it out."

B. N. Upham, president of the company, was responsible for instituting the Cost of Living Income Adjustment Plan in these stores.

JOHN WANAMAKER, NEW YORK AND PHILADELPHIA[2]

John Wanamaker, New York and Philadelphia, has taken another forthright step in leadership, in making known a plan whereby all

[1] October 30, 1941.
[2] October 31, 1941.

employees with a few exceptions will, retroactive to Oct. 1, receive an "emergency allowance" of 5 per cent of basic weekly salaries up to $40.

In addition, eligible employees whose salary exceeds $40 per week will receive the 5 per cent "emergency allowance" up to and including the maximum of $40. For example, a person receiving $60 per week will hereafter, as long as the plan is in effect, receive a salary of $62 per week.

. . . .

Mr. Shipley [president of the company] explains that the "emergency allowance" has been instituted as a method of compensating employees for the rising cost of living and to enable them better to meet this rising cost.

. . . .

The complete plan for the "emergency allowance," with the exceptions, as given to employees is as follows:

"It is my privilege and pleasure to announce on behalf of my associates and myself, the inauguration of monthly 'Emergency Allowance' payments to all members of the Store Family who are regularly on duty five days each week, with the exception of the following:

"1. Corporate Officers and General Executives.
"2. Those working on full commission basis with drawing account whose earnings have risen with the increased sales due to the times.
"3. Piece workers.
"4. Groups with whom we have contractual salary agreements.
"5. Department heads and other executives now eligible for special compensation.

"This supplemental compensation will be given to all those of the store family (except as above noted) who will have been with us at least six months. The allowance will be 5 per cent of your basic weekly salary up to $40 and will be effective Oct. 1; the first payment to be made shortly after Nov. 1 to cover the month of October.

"It is urged that everyone consider this 'Emergency Allowance' not as part of his salary but as a means of temporary adjustment during our present National Emergency.

"In this connection, however, we wish it clearly understood that the usual periodical review of basic salaries will be continued and adjustments made for those enjoying increased responsibilities or for those performing unusually meritorious service.

C. R. Shipley
President"

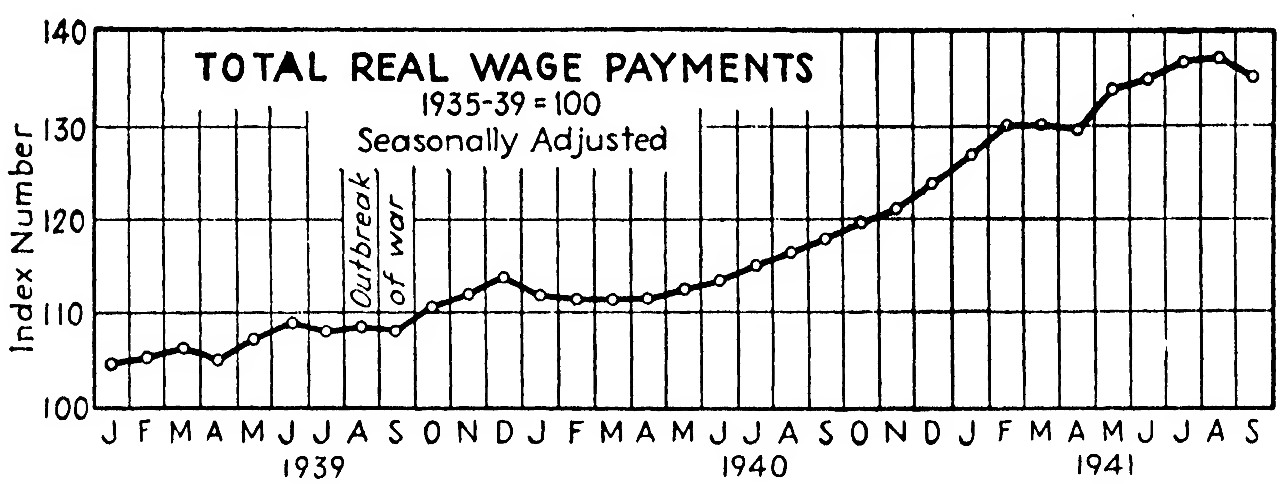
Mr. Creel argued that some kind of continuous additional compensation plan should be adopted for the duration of the emergency.

Such a plan, he stated, would have a more lasting effect than a periodic lump bonus payment and would tend to forestall union demands so long as it remained in use. He believed that a lump bonus would be forgotten soon after it was paid, with the result that the management once again would be subject to the demands of the union.

Mr. Creel believed that his plan should apply to all employees whose earnings were less than $75 weekly. Those who were paid on a straight commission basis were not to be excluded, since the

EXHIBIT 2

U.S. DEPARTMENT OF COMMERCE INDEX OF TOTAL WAGE PAYMENTS DIVIDED BY U.S. BUREAU OF LABOR STATISTICS COST OF LIVING INDEX TO SHOW EFFECT OF RISING COST OF LIVING ON CONSUMER INCOME GAINS



Source: *The New York Times*, November 28, 1941

argument that increased volume would automatically raise their earnings did not apply in the Hawthorne Company; the store's dollar volume was not expected to keep pace with the rise in prices. The $75 base was a natural bookkeeping division, because employees earning more than this amount were paid semimonthly by check, reimbursed for absences, and included under some type of bonus plan. The others were paid by envelope weekly; they suffered deductions for absences; and for them salary was the only source of income.

Mr. Creel's plan would be revised only when the cost of living index fluctuated more than five points. Thus, frequent revisions would be eliminated. Furthermore, the additional compensation plan was not to alter in any way the company's policy of conducting a semiannual review of jobs, resulting in promotions and salary increases whenever merited.

The president of the Hawthorne Company promised to consider carefully the plan presented by Mr. Creel. He agreed that some sort of additional payment plan was necessary during the emergency, because he realized that the rising cost of living had begun already to wipe out consumer income gains (see Exhibit 2). The point of disagreement was the kind of plan to be adopted. The president was of the opinion that a program for a straight bonus determined as a certain percentage of past earnings would be the best solution to the problem. He thought that the plan suggested by Mr. Creel would commit the company too far in advance. The president, furthermore, doubted the feasibility of linking the company wage scale to the cost of living index of the Bureau of Labor Statistics. A review of the movement of this index over the preceding 25 years showed that it had reached its highest point in the middle or latter part of 1920; and at that time certainly no department store would have wished to make an upward revision in wages.

After full consideration the management of the Hawthorne Company decided to adopt the plan described in the following announcement:

The Management has authorized a 5% wage bonus based on the total wages received by eligible employees during the 26-week period ending August 2, 1941, which roughly coincides with the first six months of the store's operating year.

Older employees of the store will recall that such payments were at one time quite common following years when satisfactory sales and profit showings made them possible. No such general bonus, however, has been declared during the last ten years, and this will therefore come as a pleasant surprise.

The Payroll Department will need a few days to compute the amounts of individual awards and will then pay one-half of the total in each case as soon as it is ready, an additional quarter on October first, and the final quarter on November first.

It is announced that all regular employees who receive less than $75.00 a week will share in the bonus award if they were on the payroll for the entire period between May 5, 1941, and September 10, 1941. Since the amount in each case will be 5% of actual earnings, it will be based not only on actual wages received for time worked, but on commissions, bonuses, E.P.'s, and the cash equivalent of meals to those who have meal allowances; in other words, the same figures which are used in computing the Social Security tax.

Was the management of the Hawthorne Company well advised in rejecting the personnel superintendent's plan for supplementary compensation?

7. HANDFIELD COMPANY

SALES TRAINING PROGRAM

In the spring of 1940, Mr. Alton, vice president in charge of sales of the Handfield Company, visited a meeting of the sales training class conducted by the transformer division. He was so well impressed with the apparent effectiveness of the teaching methods used that he considered the desirability of requesting the managers of the 26 other product divisions to organize similar courses. Consequently, he asked Mr. Mount, manager of the transformer division, to make a detailed report of the training program for his examination.

The Handfield Company, which had been established in 1856 as a single unit, had by 1940 expanded into seven plants located in the East and the Middle West. The company manufactured a long list of products, including electric motors, generators, transformers, milling machines, excavators, diesel-electric traction equipment, steam turbines, crushing machinery, mining machinery, sawmill machinery, and other heavy equipment. The responsibility for the development, manufacture, and sale of this equipment was divided among seven large departments, each of which included from 1 to 5 of the company's 27 product divisions. These departments were designated as follows:

Machine Tool Department
Crushing and Mining Department
Electrical Department
Engine Department
Hydraulic Turbine and Centrifugal Pump Department
Steam Turbine Department
Excavator Department

In the field, the actual distribution of Handfield products was achieved through a system of 50 branch houses and district offices. The district offices ranged in size from small offices with one salesman and a stenographer to large ones in Chicago, New York, Pittsburgh, and Philadelphia with special salesmen for each of the major products in addition to a number of territorial, or so-called "price-book salesmen." The price-book salesmen sold the standard items listed in the company's price book and had a tendency to specialize in whatever type of product was most important to the section of territory which they covered. For instance, a

salesman in Denver naturally had a thorough knowledge of mining machinery; but of course he could also sell small motors, pumps, or other products which could be installed without special technical recommendations.

In the case of the prospective sale of a large item, such as a steam turbine, the price-book salesman made no effort to carry negotiations very far without assistance. Since he was a trained engineer and probably had already secured the customer's confidence through previous contacts, he was in a position to ask intelligent and pertinent questions concerning the requirements for the proposed apparatus. With the necessary information in hand he made a report through his branch office to the sales engineer responsible for steam turbines at the main office. After he had prepared the facts and figures required, the sales engineer visited the prospective customer with the regular territory salesman and secured the additional information necessary to enable him to work out the details of the installation and to provide the basis for the company's bid.

The company followed the sale through to its conclusion on a system of record cards kept in each product division. The regular salesman's report on the progress of the negotiations or on the consummation of the sale was recorded on these cards; and if the sale did not materialize, a notation was made of the salesman's explanation for this loss of business. In a situation which required the services of a sales engineer, the sales engineer acted solely as technical assistant to the salesman; that is, he carefully avoided any appearance of replacing or superseding the salesman. This procedure enabled the regular salesman to retain the respect of his customers, since the sales engineer was presented as a technical man rather than as a salesman. Technical recommendations were thus made more easily acceptable to the customer. The importance of sales engineers in the company's distribution organization was indicated by the fact that almost half the 650 men listed as salesmen were classified as sales engineers, all experts in their respective fields.

In the large branch offices, such as Chicago, where there were as many as 50 salesmen, certain of the men specialized on particular products and called only on users of these types of equipment. For instance, the specialist in power-plant equipment maintained contacts with utilities and industrial concerns which

operated their own power plants. These accounts were assigned by name rather than in the more usual way, by territory.

In order to meet its own requirements for skilled men the Handfield Company had initiated a training program in 1903. In 1925 the program was known as the Handfield Graduate Training Course, and only graduates of recognized engineering colleges were enrolled in it. The company sent a representative to a number of engineering colleges in February of each year and offered positions in the training courses to a group of promising seniors. From 1925 to 1930 about 40 men a year entered the course; but from 1931 to 1934, when operations were at a very low level, no men were admitted, because the company was not sure of its ability to place them within the organization. In the six years 1935–1940, the number of men admitted was as follows: 24, 40, 45, 28, 0, and 40. Of this group of 177 men only 5 had left the company's employ for any reason by the summer of 1940.

When the men arrived at the factory for the training course, most of them, very naturally, did not know what they wanted to do within the company organization. Ordinarily, therefore, they were assigned for about six months to work in the factory and especially in the testing department, where they could become familiar with a great many products in a relatively short time. During the following three months they worked in the main office and acquainted themselves with the routine there. At the end of this time they returned to the factory or continued in the office at the discretion of the training director. The continual shifting of the men from one department to another meant that there might be as many as five or six students in a division at one time, while at another time there might be none.

The training director assigned the men to various kinds of work within the plant and the office partly on the basis of his judgment and observation of their capacities and interests and partly on the basis of the requests of the various division heads. It was fairly common for a division head to be impressed with the ability and aptitudes of a trainee and ask that this man be assigned to his division at the end of the two-year training period. When such a situation arose, the training director attempted to assign the man for the remainder of his apprenticeship to work that would improve his knowledge of the particular product or to work within the division which had requested his services.

The training director made every effort to keep the course flexible. Although the men were classified as trainees for the full two-year period, they were engaged in various occupations adjusted to their individual aptitudes. The training department emphasized the performance of actual day-to-day operations within the company rather than theoretical or general policy considerations. The trainees worked on all three shifts of the company's main factory or at the other factories in the company organization. They were paid by the hour at a rate which was somewhat above the minimum for the particular job on which they were working.

A company bulletin published in 1938 indicated that the men selected from the training course since 1925 had been distributed throughout the company as follows:

District Sales Offices		35.0%
Main Office Work:		
Electrical	16.0%	
Hydraulics	10.4	
Steam Turbines	6.3	
Engine	2.8	
Crushing and Mining	2.8	
Excavator	1.7	
Machine Tool	1.0	41.0
Erection Department (on the road)		7.7
Main Handfield Works Management		9.6
Management of Other Works		6.7
Total		100.0%

Since practically all the main office group were sales engineers and assistants, about 75% of the men were connected with the sales organization of the company.

After the trainees had been assigned to specific divisions, the division heads were expected to work with them and further their training in whatever way seemed best adapted to the jobs involved. Mr. Mount, the head of the transformer division, had evolved a definite course of training for the men assigned to his division. For this purpose he had written an outline, which covered not only company policies and reports but also the psychology of selling. He developed his analysis of sales psychology by suggesting methods of meeting specific objections to the company's products, by discussing methods of handling people, and by attacking particular problems, such as reciprocity and high prices.

In addition to providing this regular sales instruction, Mr. Mount had arranged for weekly discussion meetings. These meetings were primarily for the new men in the transformer division,

but several of the regular engineers and salesmen generally attended. In his report to Mr. Alton, Mr. Mount outlined the procedure of these sales discussion meetings as follows:

> A definite commercial situation is set up [see Exhibit 1], and one of the factory engineers who would ordinarily represent the factory in an actual sales negotiation is assigned the job of handling the sales situation.
>
> Other factory engineers play the parts of the representatives in the customer's organization likely to be encountered.
>
> The program is enacted without rehearsal and with the remaining members of the group sitting in the background. No comments or help of any kind are given during the "sales negotiation."
>
> After about an hour and a half, the demonstration is terminated, and the entire group takes part in the discussion, giving suggestions as to how the subject could have been handled better and bringing out points which may have been overlooked in the discussion.
>
> The purpose of these conferences is two-fold: first, to provide a means of training factory sales engineers in the proper presentation of their subjects and in handling difficult situations with customers; and second, to provide a method of testing our general sales presentation. If we find that our factory sales engineer is unable to "sell" the other engineers taking the parts of customers, the whole group works on the particular problem to find a way of presenting the matter more satisfactorily.

Although Mr. Alton was favorably impressed with Mr. Mount's report, he was not entirely convinced of the advisability of asking all the division heads to undertake this type of training. He realized that the division heads were busy men and that such a program required several hours of work each week, both in the preparation of cases and in the actual conduct of the meetings. Since it was important for the division heads not to neglect their day-to-day efforts with the trainees, these additional duties would probably involve considerable overtime work. Mr. Alton also wondered whether the discussions might not have a tendency to develop too great an emphasis on the manner of presentation of sales arguments rather than on the correct application of technical knowledge, which was, after all, the most important aspect in selling to an industrial buyer.

Should the sales training program of the transformer division have been more widely adopted in the Handfield Company?

Exhibit 1

Handfield Company

Notice of Meeting of Transformer Sales Discussion Group

A meeting of the Transformer Sales Discussion Group will be held at the Handfield Club House on Monday, March 4. Dinner will be served promptly at 5:30 p.m., after which there will be a demonstration sales conference as follows:

The Consumers Edison Company has sent out inquiries to Allis Chalmers, General Electric, Westinghouse, Handfield, Moloney, and Pennsylvania Transformer Company covering three 20,000 kva, 132,000 volt, self-cooled transformers. The specifications call for the windings to be of the shielded type of construction with varnish-treated coils, and a new synthetic paint, and the complete assembly to be able to withstand a 50-lb.-per-square-inch pressure test.[1]

The local Handfield district office manager, Mr. J. I. Allen, has made an appointment for a factory engineer, Mr. F. W. Valentine, to discuss the Handfield proposition with the customer's engineers. Mr. W. C. Sellig will take the part of the customer's Electrical Engineer, Mr. J. C. Dorchester will be Superintendent of Operation, Mr. P. M. Dennis, Superintendent of Maintenance, Mr. G. W. Calendar, System Planning Engineer, Mr. R. A. Ball, Purchasing Agent.

Following the dinner the individuals taking part in the discussion will take their places about the conference table after suitable introductions have been made. The others in the study group will occupy seats away from the table and will not take part in the discussion until the conference has been concluded. At that time there will be a general discussion relative to the possibilities of improving the Handfield sales approach to this problem.

(Signed) H. L. Mount
Engineer-in-Charge,
Transformer Division

8. DALBY COMPANY

WARTIME CURTAILMENT OF SALESFORCE

Up to 1941 the Dalby Company, located in a large midwestern city, had been engaged for an extended period in successful national distribution of its Dalby brand of household electrical appliances, kitchen equipment, and cutlery. Early in 1941 difficulty in obtaining certain raw materials forced the company to begin curtailing production of many consumer items. This development culminated with a government order, effective on June 1, 1942,

[1] Editor's Note: The factory engineer will have to make allowances for the fact that these features are not standard Handfield specifications.

requiring complete cessation of manufacture of numerous electrical appliances for civilian use. To compensate for this drastic reduction in its consumer lines, the company had gradually diverted its production facilities to war contracts; by June, 1942, over 50% of plant capacity was engaged in government work, and the remainder was devoted to the restricted manufacture of nonelectrical civilian goods. Company officials anticipated that by August, 1942, nearly 80% of capacity would be employed on war contracts. The change-over to so large a proportion of war production necessitated a substantial revision of the company's selling organization. By June, 1942, the field salesforce had been reduced from 140 to 25 men, and a number of individuals previously employed in the selling organization had been assigned to other work. The Dalby executives nevertheless sought to preserve a skeleton organization which would continue to call on distributors during the war period and which could be used after the war as a nucleus around which to build an aggressive selling organization.

The product lines manufactured by the Dalby Company prior to 1941 had comprised two major groups: electrical appliances, consisting of ranges, washing machines, vacuum cleaners, and small appliances; and nonelectrical kitchen equipment, such as food and meat choppers, bread mixers, fruit juicers, coffee mills, cutlery, and vacuum bottles. Total sales of the company had fluctuated for several years between $12,000,000 and $20,000,000, approximately 60% in electrical and 40% in nonelectrical lines. All merchandise bore the Dalby trade-mark and sold at prices consistent with the medium- to high-quality standards uniformly maintained by the company.

Channels of distribution varied considerably because of the diverse nature of the product lines, but with the exception of direct sales to large department stores the company sold to wholesale distributors for resale to retailers. Electric ranges, washing machines, and vacuum cleaners, for instance, were sold on an exclusive agency basis to electrical supply firms, hardware wholesalers, and public utility companies, while small electrical appliances and nonelectrical items were sold on a nonexclusive basis chiefly to hardware wholesalers. Vacuum bottles and certain other specialties were distributed through drug wholesalers. All electrical products were billed to distributors at 50% off list prices and were resold to retailers at 35% to 40% off list, depending on the quantity

purchased. The nonelectrical items were not discounted from list prices; instead, a net price was quoted to the distributor, with a suggested resale price to the retailer. Under this procedure there was considerable variation in wholesale and retail margins, as well as in the retail prices established by dealers.

The prewar selling organization was complicated both by the diversity of the product lines and by the variety of channels through which distribution was effected. In general, the sales of electrical lines were organized on a product basis, while the nonelectrical sales organization was set up by types of distributors. Small electrical appliances were an exception in that they were sold both to electrical supply firms and to hardware wholesalers.

The entire selling organization was supervised by a general sales manager responsible directly to the president of the company. Under the general sales manager were eight divisional sales managers, each in charge of a product or particular distribution channel, as follows: (1) ranges, (2) washing machines, (3) vacuum cleaners, (4) electrical supply firms, (5) hardware wholesalers, (6) drug wholesalers, (7) department stores, and (8) export sales. Each divisional sales manager supervised his own salesforce. Where there was duplication of sales effort because different products went to the same outlet or because the same product was sold through more than one type of distributor, the general sales manager made the necessary adjustments in conference with the divisional sales managers involved.

The Dalby Company maintained warehouse stocks at branch offices in New York, Boston, and San Francisco. The regular salesforce comprised 140 men, of whom 15, attached to the New York office, covered the territory in the vicinity of New York; 12, attached to the Boston office, covered the New England States; and 10, with headquarters at San Francisco, covered the Pacific Coast states. An additional 12 salesmen were assigned to the North Central states, and 15 to the South Atlantic states; these two groups, together with the remaining 76 salesmen, whose territories were scattered, were supervised from the home office by their respective divisional sales managers. The salesmen attached to the branch offices were under the immediate direction of the branch managers. All assignments of territories and customers, however, were made by the divisional sales managers, who also determined routes and frequency of calls.

Compensation of the salesforce combined a base salary with a bonus payment made as a percentage of sales in excess of the individual's quota. An attempt was made to set the quotas at a level which would make it possible for each salesman to earn a bonus of approximately 10% of his base salary. The general sales manager believed that this proportion did not stress sales volume to the exclusion of other desirable promotional efforts. Promotion of salesmen came through increases in the base salary. No definite plan of promotion was followed, but maintenance of good distributor relations was regarded as an outstanding factor in rating salesmen.

In addition to the regular salesforce, a limited number of missionary salesmen were maintained on straight salary to work with distributors' salesmen in selling to retailers. Sometimes the missionary salesmen were younger men who subsequently were placed on the regular salesforce if their work demonstrated promotional and sales ability.

To supplement the work of the salesforce, the Dalby Company spent approximately 4% of sales in other forms of sales promotion. The expenditures were divided about equally among national magazine advertising to consumers, cooperative newspaper advertising with dealers, and trade paper, direct-mail, and catalogue advertising to distributors. The company also provided point-of-purchase displays and demonstrations in department stores. The range division supplied factory demonstrators to conduct cooking schools in cooperation with the larger retailers.

In January, 1941, it became apparent that inability to obtain adequate supplies of certain materials would force a general curtailment of production of consumer goods. Throughout the spring and summer, orders for Dalby products were unusually heavy; and by August the plant's entire output of consumer goods for the calendar year had been sold. To prevent further maladjustment between sales and production, therefore, the officers of the company decided to reduce the salesforce; and in September, 1941, approximately one-third of the 140 salesmen were released. By January, 1942, conditions had become so acute that another third of the original group were released. About 40% of the men dismissed had poor sales records and were not regarded as sufficiently capable to warrant future consideration. The other 60% were told that the company would welcome their applications for reemployment after the war. Wide geographic distribution of these men precluded their easy

diversion to other work in the Dalby organization. To facilitate their placement elsewhere, all salesmen dismissed were granted 90 days' notice with full salary plus accrued bonus; all of them, in fact, found other employment before their term of notice expired. About 80% of them went into war industries.

A final dismissal occurred in April, 1942, when it became known that all production of major electrical appliances for consumers would cease by government order effective June 1, 1942. This last step reduced the company's salesforce from 46 to 25, or to approximately 18% of the original number. Of the 21 men dropped from the salesforce, the company retained 12, 8 for production work at the home plant, 2 for work in supervising subcontracts, and 2 for administrative positions on war contracts.

With electrical lines discontinued and the salesforce for non-electrical goods greatly reduced, it became obvious that not all the divisional sales managers would be required in their regular capacities. In order to keep these men available, some who were not needed in sales work were diverted. The manager for ranges took over priorities and spent much of his time in Washington; the manager for washing machines went into production control work for war contracts; the manager for vacuum cleaners headed a proposed parts and service program to help bolster the position of distributors; the manager of sales to electrical supply firms was released; the manager of sales to hardware wholesalers continued to function, since the kitchen equipment and cutlery lines, which were now the only civilian products manufactured by the Dalby Company, customarily were sold through the hardware trade; the manager of department store sales was granted a leave of absence to engage in war work, and his division was combined with the division selling to hardware wholesalers. The sales managers for the drug and export divisions continued to function in their original capacities on limited volume. The San Francisco branch was closed, and warehouse stocks were discontinued for lack of inventory. Branch managers in the two remaining districts continued to direct the restricted sales and service effort in their territories.

With this major retrenchment in the company's selling organization, it was inevitable that distributor contacts should be greatly impaired. Nevertheless, the general sales manager wished to continue the established relations with larger distributors in order to be assured of a postwar distribution system for the company's

consumer goods lines. As a preliminary step to the realization of this objective the 25 remaining salesmen were assigned widespread territories in order to maintain a thin national coverage. By eliminating calls on some small distributors and reducing the frequency of calls on others, the 25 salesmen presumably would be able to keep in touch with the most important distributors in the various trades.

The only lines available for sale to distributors were non-electrical goods. Even these were produced in such limited quantities that orders were filled pro rata in accordance with the distributors' prewar purchases. To supplement their limited selling activities, salesmen devoted considerable time to acquainting each distributor with government regulations affecting his business. In this connection information on priority ratings and shortages of various metals proved helpful. Another important contribution related to the inventory restrictions imposed on distributors and dealers and the interpretation of general maximum price regulations emanating from the Office of Price Administration. In all their work with distributors, salesmen were urged to emphasize the desire of the Dalby Company to be of service. It was hoped that goodwill could thus be maintained and distributors induced to continue their affiliation with the Dalby Company.

In June, 1942, the general sales manager realized that some more tangible aid to distributors was desirable in order to augment the limited sales of regular consumer lines. The problem of furnishing adequate service for electrical appliances was expected to become serious as the sale of new units declined and ultimately ceased. Vacuum cleaners, particularly, required periodic overhaul and replacement of worn parts. The company would be able to manufacture a substantial volume of repair parts under its production restrictions; and after considerable deliberation the general sales manager proposed the adoption of a program for the servicing and repairing of vacuum cleaners, under the direction of the divisional sales manager for that product. The proposed service plan centered in the development of a repair kit which would include the replacement parts most commonly required in reconditioning vacuum cleaners. To facilitate the sale of the kits to distributors, it was suggested that dealers in large cities throughout the country be appointed as authorized service agents. By this means it was anticipated that sales volume of both distributors and dealers would

be helped as the demand for repair and maintenance service for vacuum cleaners increased during the war period. As a promotional aid to the plan, a substantial part of the advertising appropriation would be used in trade papers to acquaint distributors and dealers with the salient features of the service. If the proposal was adopted and proved successful, a service kit for washing machines might next be developed.

One executive expressed some doubt as to the feasibility of the service plan. It was his opinion that, if the war continued into 1943, many distributors would be forced out of business by lack of an adequate sales volume to carry overhead. He questioned whether sales of service parts, even on a more extensive basis than could be predicted, would compensate the distributors sufficiently for their loss of sales of original equipment. He advanced the opinion that the Dalby Company might well have to rebuild its distribution organization completely after the war, and that therefore the current development of a service plan as a device to maintain existing relations with distributors was not justifiable. The general sales manager dissented from this view. He continued to argue that the service plan was the best available method to maintain a skeleton sales and distributor organization which would minimize the cost and loss of time in rebuilding the distribution system for the company's consumer goods after the war.

To what extent should the management have endeavored to preserve its existing sales organization and its pattern of distributive relationships?

C. USE OF ADVERTISING

1. CALIFORNIA FRUIT GROWERS EXCHANGE

USE OF ADVERTISING TO EXPAND MARKET

The California Fruit Growers Exchange, a cooperative marketing association, was organized in 1905 as a successor to the Southern California Fruit Exchange,[1] a federation of smaller associations.

[1] R. M. MacCurdy, *The History of the California Fruit Growers Exchange* (Los Angeles, 1925), pp. 51–52.

The development of these marketing organizations had received strong impetus from conditions in the citrus fruit market which had brought prices for the fruit to ruinously low figures. In order to stimulate sales, the association decided in 1907 to undertake an advertising program.

The members of the local associations affiliated with the California Fruit Growers Exchange were fruit growers. Each local association assembled the fruit in its packing house, and graded, packed, and prepared it for shipment. Several associations picked the fruit for their members. It was a common practice for each local association to pool the shipments of its members, sell the fruit without maintaining the identity of the shipments of each individual grower, and divide the proceeds from the sale pro rata. Such pools usually were on a monthly basis.

The membership in the local associations was voluntary and for one year only. Every grower reserved the right to regulate and control his own shipments, develop his own brands, and use his own judgment as to how, when, and where his fruit should be shipped and what prices he would accept. As a matter of practice, however, the growers were influenced largely by the advice of the central exchange.

The local associations were grouped into district exchanges, which acted as clearing houses and were operated on a nonprofit plan. These district exchanges kept records of shipments and destinations and obtained reports from the central exchange concerning market conditions. Through the central exchange, instructions were issued regarding prices and destinations, and for the diversion of cars and trains in transit in order that the fruit might be sent to the most favorable markets. Although only a small percentage of the total shipments actually were diverted in transit, these diversions preserved the balance of the market.

The chief markets for California citrus fruits were in midwestern and eastern cities. The fruit was shipped in trainloads on regular daily schedules throughout the year. Refrigerator cars were used, and precooling stations had been established in order that the temperature for shipments might be regulated. The central exchange acted as a clearing house for the district exchanges. It had representatives in all the important markets in the country, from whom advice was received constantly regarding market conditions and prices. The fruit was sold for cash, and payment

was made through the central exchange. The exchange also collected claims for damage and loss in transit. The quantity of fruit shipped through this exchange increased steadily.

There were several significant reasons for the development of this cooperative organization. In the first place, at the time the movement gained headway most rapidly, there was dissatisfaction among the growers over their relations with buyers, commission merchants, and others to whom their fruit was sold. Their product was increasing in quantity, and prices were falling. The markets were frequently glutted, and the middlemen were commonly blamed for low prices and losses. The growers found that they could obtain lower freight rates, faster transit, and better delivered condition of their fruit if they were in a position to con-

EXHIBIT 1

CALIFORNIA FRUIT GROWERS EXCHANGE AND ITS PREDECESSOR

Annual Sales of Oranges, Grapefruit, and Lemons, 1896–1941

(Value f.o.b. Cars in California)

Season Ending*	Sales Value	Cars	Season Ending*	Sales Value	Cars
1896	$ 1,032,212	2,487	1919	$54,627,556	33,165
1897	858,029	1,789	1920	58,967,388	34,461
1898	1,671,230	4,025	1921	56,905,876	40,959
1899	1,713,514	3,000	1922	48,445,644	27,138
1900	3,643,791	6,039	1923	55,271,975	45,258
1901	4,799,000	11,027	1924	50,508,184	44,266
1902	4,385,472	7,309	1925	70,236,507	37,258
1903	4,497,919	9,621	1926	70,744,727	46,593
1904	5,062,594	13,072	1927	85,295,841	50,468
1905	7,124,377	14,219	1928	96,582,408	44,521
1906	9,936,497	12,884	1929	89,758,641	65,417
1907	12,268,752	16,217	1930	104,902,615	46,377
1908	11,753,544	17,636	1931	77,327,358	63,750
1909	13,958,990	22,954	1932	59,856,459	58,201
1910	14,831,975	19,639	1933	52,238,077	56,079
1911	20,708,355	28,123	1934	73,298,730	61,217
1912	17,235,822	23,648	1935	72,399,391	71,944
1913	13,640,091	12,432	1936	84,864,322	64,188
1914	18,990,725	28,186	1937	82,564,229	47,569†
1915	19,523,397	29,812	1938	63,056,462	71,702
1916	27,675,922	29,828	1939	59,224,799	63,733
1917	33,478,130	36,219	1940	....	73,227
1918	36,291,675	19,214	1941	....	80,393

* Fiscal years ending August 31 to 1920–21 season and October 31 thereafter.

† In addition, 6,202 cars of loose fruit were shipped, fruit which was below grade because of the heavy freeze of January, 1937.

Source: R. M. MacCurdy, *The History of the California Fruit Growers Exchange* (Los Angeles, 1925), p. 70, and the *Annual Reports of the General Manager of the California Fruit Growers Exchange* for 1925–1933.

tract with the railroad companies for the regular shipment of trainloads. The growers also had been gaining experience in united action through their irrigation projects and through the need for coöperation in the protection of their orchards. The citrus fruit industry in California was specialized and required large capital.

EXHIBIT 2
CALIFORNIA FRUIT GROWERS EXCHANGE
Selling and Advertising Expense as Percentage of Delivered Value of Goods Sold

Year Ending	Selling and Advertising Expense	Year Ending	Selling and Advertising Expense
1905	3.28%	1924	3.04%
1906	2.89	1925	2.40
1907	2.65	1926	2.48
1908	3.05	1927	2.41
1909	3.44	1928	2.30
1910	3.57	1929	2.68
1911	3.25	1930	2.30
1912	3.53	1931	3.66
1913	2.62	1932	3.90
1914	3.31	1933	4.09
1915	3.72	1934	3.38
1916	3.14	1935	4.00
1917	3.01	1936	3.20
1918	1.79	1937	3.31
1919	1.62	1938	4.54
1920	2.01	1939	4.28
1921	2.32	1940	4.07
1922	1.69	1941	3.95
1923	2.49		

Source: *Annual Reports of the General Manager of the California Fruit Growers Exchange.*

After entering upon its advertising program, the California Fruit Growers Exchange developed the Sunkist brand of citrus fruits. Only first-quality fruit was permitted to bear this brand. Shipments that were not up to the standard were sold under other brands or unbranded. This brand was one of the chief means that the Exchange used for developing a demand for the products of its members.

The increase in the volume of sales of oranges, grapefruit, and lemons by the Southern California Fruit Exchange and its successor, the California Fruit Growers Exchange, in the period from 1896 to 1941 is indicated by the statistics in Exhibit 1. This record covers 11 years preceding and 35 years following the inau-

guration of the advertising plan. In 1940 the expenditures of the Exchange were $2,161,309; and the 1941 total, although the exact figures were not reported, was even larger. Total advertising and promotional expenditures from the beginning of advertising in 1907 through 1937 amounted to $24,453,043 and represented 1.12% of the delivered value. Expenditures from 1937 to 1941 averaged over $2,000,000 a year. In the 1930 decade the expenditure for advertising and promotion was generally at the rate of 5 cents a box for oranges, 10 cents for lemons, and 3 cents for grapefruit. These rates were varied, however, to meet unusual crop conditions. For instance, in 1937, 1938, and 1941, the advertising assessment for all oranges was 7 cents a box, while in 1935 and 1940 it was 5 cents for navels and 7 cents for valencias. In 1941 the assessment for lemon advertising was at the rate of 12 cents a box, while that for grapefruit was reduced to 1 cent a box. The annual ratios of the total selling and advertising expense to the delivered value of the sales for 1905 through 1941 were as shown in Exhibit 2.

The following excerpts from the *Annual Report* for 1941 give a picture of the advertising and promotional efforts of the Exchange:

> One of the generally accepted factors in the increased sales volume and improved market this season is the Sunkist advertising and merchandising campaign, which was the most extensive in the 34 years since it was begun. Based on these results, the Exchange board of directors approved continuation for the coming season of the advertising investment of 7 cents per packed box on oranges and 12 cents on lemons.
>
> In order to further widen distribution and increase consumption of citrus fruits—of Exchange brands in particular—the advertising and merchandising coverage of United States and Canadian markets, large and small, was the most complete ever attained. Likewise the coordination with sales efforts in the markets was accomplished to a greater degree than ever before. The wholesale and retail trade attest the value to themselves as well as to the growers of the increased promotion effort.
>
> A wide selection of media carried Sunkist advertising this season. Color pages in magazines and Sunday newspapers presented the basic health and appetite appeals. Daily and weekly newspapers and radio provided the flexibility for meeting the needs of individual markets and seasons, and were supplemented with farm and small town magazines, outdoor posters, and spot radio.
>
> Knowledge of your product, your competition and your market is prerequisite to productive advertising. Exchange consumer surveys,

plus citrus sales statistics and a wealth of information from governmental authorities, Exchange salesmen, and other sources, are used in allocating Sunkist advertising. Each market in every sales district is analyzed and given its full share of the kind of advertising that it is thought will bring the best results.

Canadian and Hawaiian markets received newspaper advertising on both oranges and lemons.

The Sunkist network radio program was again shared equally by lemons and oranges, with 3 fifteen-minute broadcasts weekly on forty CBS stations throughout the year. The program, "Hedda Hopper's Hollywood," was among the most popular of daytime features and provided wide coverage of small town and rural consumers as well as of the forty major markets in which it was released.

Lemon Advertising

The imperative need for more rapid increase in consumption of lemons overshadows the fact that much progress is being made. Per capita consumption of lemons has not kept step with increases in orange and grapefruit consumption it is true, but it has increased 21% from the early twenties to the past two years, while per capita consumption of all fruits other than citrus has declined. Lemon shipments have been increased 86% in this period. However a problem still exists due to the fact that during these years lemon production has increased by 184%.

Lemon uses are so many and so varied that not all can be featured at any one season or in a single advertisement. The major uses—cold lemonade, hot lemonade, lemon-and-soda or lemon and water, general food uses, beauty uses and household uses—were advertised extensively this season. The use of lemon-and-soda has increased 160% in the three years since its advertising began; the use of lemon and water 38%.

Navel Advertising

The sales slogan "Best for Juice and Every Use" was the theme of Sunkist and Red Ball navel orange advertising, with strong emphasis on quality of fruit and juice. This slogan with the quality appeal is rapidly taking hold with consumer and trade alike and is considered the best appeal ever developed to sell Exchange fruit on a quality basis.

To provide the sales support needed in the competitive areas, more localized media—newspapers along with network and spot radio—were used in greater degree. Reminder media—24-sheet posters and painted bulletins—were also widely used.

Coverage of small towns and rural markets by radio, magazines and city newspapers was augmented by the use of 2,600 weekly newspapers.

Valencia Advertising

Taking advantage of the great interest in vitamins, stimulated by the Government's efforts to raise health standards as part of the

National Defense program, summer orange advertising headlined "Get Your Vitamins the Natural Way—From Foods," along with the superior-quality story, in a variety of appetite and health appeals.

In the largest valencia advertising campaign in history, the Exchange used 313 daily newspapers in 213 cities, weekly newspapers in 2,606 small towns, color pages in leading women's and general magazines and in the Sunday magazine sections of metropolitan newspapers in 49 cities.

"Hedda Hopper's Hollywood" was supplemented with spot radio announcements in 26 southern markets. Two outdoor postings appeared in 135 cities, with painted bulletins added in seven of the largest markets.

Largely in response to coupon offers in magazines and radio advertising 325,000 consumer booklets were distributed during the year, including 152,000 lemon recipe books and 142,000 orange recipe books.

Foreign Advertising

Sunkist advertising activities continued through the Manila sales office and in Hong Kong. Sunkist radio programs from Manila reached many important Oriental markets. Magazine copy in native dialects, English and Chinese was supported with personal dealer service. Cooperative dealer advertisements in newspapers were also used in the Manila district. In Hong Kong, newspapers, magazines, posters and films were used, with considerable distribution of Sunkist recipe booklets in Chinese.

Dealer Service

The Sunkist dealer service division completed its 26th season with 66 men making 125,270 calls and installing 74,678 displays in 3,779 cities and towns—all new record figures. With jobber service displays and pieces distributed to the trade in response to trade advertising and direct mail, the total number of pieces exceeded 2½ million.

During the winter, 48 men devoted their entire time to the promotion of oranges and lemons, while four men included the promotion of grapefruit also in their work. One man serviced institutional outlets exclusively and one man was assigned to special merchandising research problems on lemons. Five trained men divided their time equally between sales and dealer service work. Two men were occupied entirely in a supervisory capacity.

With prospects of a large crop of valencias, ten additional men were added in May, to make a total of 66 men, the most in Exchange history, permitting the extension of personal service to many towns that had not previously been worked. The expansion of personal work to small markets was planned to capitalize upon consumer advertising in the outlying districts. Sales office employees supported the advertising program by making 7,382 fresh fruit and extractor calls.

Working closely with district sales offices, dealer service men were responsible for many special sales promotions with corporate chains

and voluntary groups. Soda fountain and chain drug groups also supported Sunkist fruit with special promotions, with 5¢ lemonade sales a notable example. Cooperative merchandising with other advertisers in beverage and breakfast food fields was continued.

The jobber service program, in its second year, continued to expand in its efforts to aid jobbers and their salesmen in rendering merchandising service to their retail customers. The jobber service bulletin, with display and sales ideas and offer of special display material, was mailed each month to 11,000 jobbers and their salesmen, with 18,000 copies of the "Sunkist Advertising News," picturing and explaining the whole Sunkist campaign, sent quarterly to jobbers and leading retailers.

Advertisements in wholesale and retail trade papers this season featured the following statements: "Sunkist supports the orderly distribution of citrus fruits from California and Arizona—which stabilizes the market—assures the trade of an opportunity to profit. Likewise, Sunkist maintains the standard package and markets its fruit through regularly established trade channels. Stick to Sunkist for Profit."

Although in its third year, "Sunkist For Profit" is still a popular film with the wholesale and retail trade. During the past year 10,896 dealers viewed the film at a total of 221 meetings.

Grapefruit Advertising

The smaller advertising assessment on grapefruit (1¢ per packed box) necessarily reduced the promotional work on this variety. Three men in the western division devoted part time to grapefruit during the winter months. Twenty regular orange and lemon men were given special assignments during the summer of sampling this fruit to retailers who were not stocking grapefruit. The plan proved effective in gaining distribution and support for the jobbers.

Army Coverage by Dealer Service Men

Sunkist dealer service men called on all Army central purchasing offices, buying posts, hospitals, and exchanges, to make sure that the maximum of Sunkist fruit is being used by the military forces. Special recipes and buying guides were distributed to these outlets.

Extractor Sales

The extractor sales division sold 2,229 large Sunkist commercial juice extractors, which was an increase over sales of the previous year. Several hundred Sunkist "magic strainer" commercial extractors were sold to the various departments of the Army and Navy for use in cantonments, hospitals and on ships. Sales of Sunkist "juicits," the household extractor, reached 19,374, and of glass reamers 22,325.

To explore the possibilities of serving fresh orange juice and lemonade in dispensers, a series of tests was begun in Chicago. Refrigerated dispensers which hold ten gallons of orange juice or lemonade

were placed in a hotel, restaurant, hospital, and several soda fountains. These dispensers had formerly proved effective in use in California.

The special citrus belt campaign, with the support of civic groups and growers, continued to promote greater citrus consumption in many producing areas, especially in the service of orange juice in schools.

Nutrition Research

The Exchange nutrition research division, collaborating with research workers in medical schools and universities, has greatly extended the more exact knowledge of the therapeutic use of citrus fruits. With the increased emphasis placed on nutrition as a factor in national health, the Exchange was able to place the most pertinent findings of its research program at the disposal of governmental agencies directing nutrition activities.

The importance of vitamin C in promoting better and more rapid healing of surgical wounds, and the advantage of using fresh citrus fruit juices in laying down collagen, or intercellular cement substance, at a more rapid rate were clearly shown through one of the research studies supported by an Exchange fellowship. This project was recorded in motion pictures to make the technique and findings more readily available for teaching of medical students and for post graduate courses of medical and surgical groups. The film, a two reel color-sound film, is being made available to professional groups, such as hospital staff meetings, and points to the clinical advantage of preparing surgical patients for operation through the routine administration of orange and lemon juice prior to operation.

Considerable progress was made on the application of lemon citrin or vitamin P, of which lemon peel is a rich source, in the treatment of a number of conditions other than skin hemorrhages, for which it was originally developed. Preliminary findings, both experimental and clinical, indicate that it may be of value in the treatment of high blood pressure, and large scale studies are under way in a number of institutions. Another application of the crude water extract of the peel combined with lemon juice was reported in medical journals as a treatment favorably influencing psoriasis, a skin disease hitherto resistant to medication.

Reprints of scientific papers dealing with the use of citrus fruits are distributed through the nutrition research division, and a journal called "Nutrition Research" is published quarterly and mailed to a list of more than 15,000 physicians, dentists, dietitians, nurses and public health teachers. Numerous medical and university libraries list "Nutrition Research" as a research periodical.

Home Economics and Education Division

First step in a campaign to introduce orange juice as a universal feature of school lunchroom service was the distribution of 53,802

copies of a leaflet, "Orange Juice in School Health Programs." The leaflet summarizes important information from the Sunkist booklet, "Feeding the Child for Health," and gives practical directions and cost data helpful in school lunch service. This material has proved especially popular since it ties in well with the current interest in better diets as a part of national defense.

The natural-color film, "Citrus on Parade," was again offered to home economics classes and women's groups and was shown to audiences totaling over a million people. Distributed at these showings were almost half a million copies of a leaflet giving directions for preparing the forty citrus fruit recipes pictured in the film. Showings were also made of a one-reel black and white film, "The Golden Journey," prepared for elementary grades.

In addition to testing new uses of citrus fruit, the Sunkist kitchen sent out during the year a continuous series of food releases and photographs to magazine and newspaper food editors and home service workers throughout the country. Through these, the key women who give the housewife her food information are kept informed on citrus crop conditions as well as furnished with the newest ideas in citrus fruit recipes, their preparation, service and food values.

In all, this division of the advertising department reached 47,485 teachers, nurses, dietitians, dentists, physicians and other professional workers, while distribution of educational numbers for the school year together with those placed in the health field totaled almost five million pieces.

Products Investigations

Investigation relative to medical application of citrus pectin was widened to include chemical and biological research. Anticipating the use of pectin as a blood substitute in transfusions, it was demonstrated that pectin, unlike acacia previously used, does not persist as unwanted accumulations in the livers of animals tested. This, combined with knowledge permitting control of the molecular size of pectin, was an important contribution by the department this year to intravenous use of pectin, besides other advances in the administration by mouth of this increasingly important food-medicament.

Other work of a biochemical nature included further investigation of vitamin P, juice problems with emphasis on vitamin retention, and the discovery in citrus juices of some proteolytic enzymes and activators. These latter are of importance not only to the manufacture and use of concentrated juices but also may play a significant part in the digestive process where citrus fruits are included in the diet.

Relating to industrial chemistry, there were developed further applications of the newer citrus pulp derivatives—pectin albedo, pectic acid and pectate pulp—sufficiently recognized to demand their regular manufacture during the year.

The *Annual Report* for 1941 carried a table showing the per capita consumption of fresh fruits in the United States from 1920–21

EXHIBIT 3

UNITED STATES PER CAPITA CONSUMPTION OF FRESH FRUITS

Five-year Averages, 1920–1940, and Percentages of Increase for Period 1920–1925 to 1935–1940

(Pounds)

5-year Averages	Oranges	Lemons	Grapefruit	Total Citrus	Apples	Apricots	Bananas	Cherries	Cranberries	Grapes	Peaches	Pears	Pineapples	Plums and Prunes	Strawberries	Total excluding Citrus	Total Fresh Fruits
1920–1925	12.6	3.8	5.2	27.2	50.9	0.3	17.8	0.5	0.5	15.2	11.7	4.9	0.9	1.3	3.1	107.2	134.4
1925–1930	13.5	3.7	5.5	29.8	42.6	0.2	22.5	0.9	0.5	19.7	11.3	5.2	1.1	1.4	3.2	108.8	138.6
1930–1935	16.5	3.6	7.3	37.0	38.9	0.3	17.8	1.3	0.5	16.1	10.1	5.0	0.8	1.3	3.1	95.3	132.3
1935–1940	18.4	4.0	10.2	44.2	41.0	0.3	20.4	1.4	0.5	20.9	11.2	5.9	1.0	1.0	3.0	106.8	151.0
Percentage Increase 1920–1925 to 1935–1940	46%	5%	96%	63%	−18%	0%	15%	180%	0%	38%	−4%	20%	11%	−23%	−3%	−1%	12%

Source: *Annual Report of the General Manager of the California Fruit Growers Exchange for the Year Ended October 31, 1941.*

through 1940–41, based on Exchange data and U.S. Department of Agriculture figures, from which Exhibit 3 has been drawn up.

Have the results achieved justified the expenditures for advertising by the California Fruit Growers Exchange? Is the conclusion equally as valid from a social as from a business standpoint?

2. PHILLIPS AND BENJAMIN COMPANY

USE OF ADVERTISING TO INTRODUCE NEW PRODUCT

In August, 1935, the executives of the Phillips and Benjamin Company of Boston reviewed the methods which the company had used to promote sales of Stera-Kleen, a new preparation for cleaning dentures without brushing. The company had found sampling to be a satisfactory method of stimulating demand, but its experiments with newspaper advertising had shown varying results in effectiveness. In the summer of 1935 the officers of the company were not in agreement with respect to the place of advertising in the promotional program and were trying to reconcile the different opinions before deciding on future policies for the promotion of Stera-Kleen.

Stera-Kleen had been invented by Dr. Sherwin, a practicing dental surgeon, for cleaning artificial teeth and removable bridges without brushing. Manufactured in powder form it comprised an exact mixture of a number of primary chemicals flavored with certain essential oils. When dissolved in the correct amount of water, Stera-Kleen formed a solution which cleaned dentures during an immersion of only 5 or 10 minutes but which did not harm them if they were left in it indefinitely. The ingredients were not injurious, but rather beneficial, to the tissues of the mouth and were harmless if swallowed.

Stera-Kleen had come to the attention of H. V. Phillips and C. B. Benjamin in the early part of 1931, when they were actively associated as vice presidents with McKesson & Robbins, Inc. In 1932, after obtaining permission from McKesson & Robbins, Inc., Mr. Phillips and Mr. Benjamin secured an option on the product from Dr. Sherwin; and with his help they then began a series of tests to ascertain more extensively and more definitely what

individual reactions to the product were and what experience dentists had had with it as an aid in dental hygiene. Without exception, the results of these tests showed that reactions were favorable. Further experiments conducted in dental laboratories also revealed that the product did not harm either the materials of the denture or the tissues of the mouth. Upon the satisfactory completion of the tests, Mr. Phillips and Mr. Benjamin decided to organize a company to manufacture and distribute the new product. They reached an agreement with Dr. Sherwin and incorporated the Phillips and Benjamin Company in Connecticut on July 20, 1933. Under the terms of the contract with Dr. Sherwin, the new company had the sole world rights to manufacture and distribute the product according to his formula.

In the opinion of executives of the company, Stera-Kleen solved the problem of denture cleanliness which had always confronted the dental profession and those who wore dentures. An unclean denture was a possible source of danger and dissatisfaction to the patient, for it might be the cause of infection or other disagreeable consequences. Dentists desired, furthermore, to protect their patients as much as possible from any discomfort in the wearing of dentures. Until the introduction of Stera-Kleen, however, they had been forced to advise patients to brush dentures with abrasives or scouring powder or to use salt, soap, or soda, since ordinary dentifrices were not adaptable for this purpose. Brushing in itself was harmful to a denture because it tended to wear away the accurate precision of ridges which were necessary to make a plate fit. Brushing also was likely to bend delicate clasps and warp the plate.

The executives of the company believed that the potential market for Stera-Kleen was immense. They estimated that in the United States there were 21,000,000 people who wore dentures or removable bridges. Calculations for this figure were based on the following factors: sales of dental adhesives, reports from dentists and dental colleges, and production figures reported by dental laboratories where dentures were made. Some laboratories reported production figures as high as 15,000 dentures monthly.

The Phillips and Benjamin Company first offered Stera-Kleen for sale in 30-cent and 60-cent packages. A 10-cent size for sampling purposes was added to the line in 1935. The 60-cent bottle held 30 capfuls, or enough powder to last a month if used once a

day. The 30-cent size contained less than half as much as the 60-cent size.

In 1935 the company distributed Stera-Kleen through drug wholesalers and retailers and through drug chains. Merchandise was billed to wholesalers at the retail list price less 33⅓%, less 16⅔%; the wholesaler was to allow the retailers 33⅓% from the retail list price. On introductory offers to retailers the company usually allowed 40% for the retailer and 16⅔% for wholesalers; the additional allowance to retailers was effected by a free goods adjustment. Chain stores were allowed to buy at wholesalers' buying prices, and special arrangements were made with them regarding introductory offers and promotional efforts.

In November, 1933, the executives of the Phillips and Benjamin Company undertook actively to develop the market for Stera-Kleen; but up to October, 1934, they still regarded all their activities as largely experimental. The time from the organization of the company in July, 1933, until November, 1933, had been spent in preparing the package, purchasing supplies, and performing other duties incidental to the beginning of a business.

Operating costs, including all developmental expenses, for the period from July, 1933, to October, 1934, were as follows:

Legal and Organization Expense	$ 3,363
Printing	8,139
Postage	3,751
Advertising	8,610
Salesmen's Salaries	2,972
Traveling Expense	3,439
Officers' Salaries	13,675
Office Salaries and Expense	3,274
Rent	363
Auto Expense	388
Freight and Express	1,601
Taxes	299
Royalties	300
Other Expense*	757
Total	$50,931

* Includes bad debts, moving, and insurance.

As a first step in securing distribution, the company in 1933 had tried to persuade all drug wholesalers in New England to make an original purchase of Stera-Kleen on the basis of payment at the time of a reorder. The management had repeatedly circularized all dentists in New England to inform them of the product, and it had also sent them samples and a prescription pad. Simultaneously the company had mailed advertising material to druggists

in the same area and had sent a free bottle to every dentist and druggist in Connecticut and Rhode Island. Company officials found, however, that these methods were only partly effective, were slow in producing results, and were expensive.

Mr. Phillips and Mr. Benjamin next considered the possibility that dental laboratories might provide the logical means for the promotion of Stera-Kleen, since dental laboratories made 95% of the dentures. The executives of several dental laboratories in and near Boston, moreover, had requested samples of Stera-Kleen to distribute with every denture which they sent to dentists for delivery to patients. Upon making the decision to try this method of promotion, the officers of the Phillips and Benjamin Company visited between 700 and 800 dental laboratories located in various parts of the United States. They supplied each laboratory with samples for distribution with new dentures. To each sample was attached a special slip with the name of the laboratory. In addition to visiting laboratories, the officers also called on wholesalers and a few key retailers in each section and solicited orders for Stera-Kleen on a "pay-on-reorder" basis. The entire project proved to be costly and not productive of satisfactory results. Frequently the managers of the laboratories failed to distribute the samples. In some instances, furthermore, when the patient was satisfied with the sample and wanted to make a purchase, he could not find the product at retail drug stores, for the Phillips and Benjamin Company had not secured adequate retail distribution.

Soon after its formation the company had undertaken a program of advertising. Many of the early efforts, however, the officials believed had been ineffective. An attempt had been made to advertise to consumers through newspapers in several cities. The management attributed the lack of success in this advertising to the nature of the copy which an advertising firm had prepared. To gain national distribution, the company had advertised in trade papers reaching drug wholesalers and retailers; but here again the desired results had not been achieved because, in the opinion of the officers, the copy was at fault. Approximately 100 wholesale outlets, however, were secured. The company also had pursued a consistent policy of advertising in a number of dental magazines. In this case, officials believed that the advertising had aided materially in stimulating the interest of the dental profession and that it had been responsible for a growing volume of business traceable

to recommendations of dentists in places where the company had undertaken no direct sales stimulation.

In the fall of 1934, company officials decided to test various copy appeals through direct advertising to the public in New England newspapers. After a thorough investigation the company engaged an advertising agency which appeared to have a good understanding of the problems involved. As a first step, the agency made tests with different copy appeals in Framingham, Newburyport, Taunton, and Gardner, Massachusetts. Mr. Phillips and Mr. Benjamin were of the opinion that the Framingham campaign had been a phenomenal success; furthermore, on the basis of costs, as shown in Exhibit 1, they believed that all the campaigns had been successful, since manufacturers of proprietary drug products judged an expenditure for promotion justifiable when the cost of starting a new user was not over three times the retail value of the product itself. To determine how effective the type of campaign used in Framingham would be under various conditions, the agency conducted similar campaigns in 25 cities and made a complete check in several of these cities, as shown in Exhibit 1. Results corresponded closely to those of the original campaign.

Although these test campaigns indicated definitely the effectiveness of advertising in increasing the sales of Stera-Kleen, the executives recognized that advertising in key markets of the United States would be expensive; and they wanted to try other promotional means before proceeding with an extensive advertising campaign. Some method or methods of placing samples with prospective purchasers appeared to offer the most feasible substitute for advertising and yet would secure adequate promotion of the product.

Before beginning an intensive sampling program, the officers believed that they should reconsider the size of samples. Previously the samples had contained a two days' supply of the powder. They thought that a sample containing a week's supply might more effectively show consumers the merits of Stera-Kleen and convince them of the necessity for its daily use. In order to test this theory, the officers distributed to dentists' patients in two New England states 16,000 sample vials, each containing a week's supply. A spot check of the results showed that 74% of the people who received a sample said that they intended to buy Stera-Kleen or had bought it.

EXHIBIT 1

PHILLIPS AND BENJAMIN COMPANY

Summary of Newspaper Test Campaign, 1934

City and Newspaper	Space (Number of Lines)	Frequency of Insertions (Times per Week)	Total Number of Insertions	Total Cost of Campaign Space	Total Number of Drug Stores in City	Number Used in Test Campaign	Total Quantity Sold in Test Stores		Cost of Making a Sale
							Large Size	Small Size	
Framingham, Mass., *News*	70	3	24	$ 84.00	11	7	161	228	$0.216
Taunton, Mass., *Gazette*	..	..	1,400 lines	70.00	...	..	30	56	0.814
Gardner, Mass., *News*	3–28	3	24	80.64	...	6	118	166	0.284
Augusta, Me., *Kennebec Journal*	70	3	12	34.50	8	2	73	109	0.190
Brunswick, Me., *Record*	70	1	4	10.00	...	1	24	48	0.139
Hartford, Conn., *Times*	70	3	15	157.50	102	8	391	305	0.226
Lewiston-Auburn, Me., *Journal*	70	3	12	109.20	21	6	96	120	0.506
Lowell, Mass., *Courier Citizen*	70	3	12	58.80	45	1	144	300	0.132
Portland, Me., *Express Herald*	70	3	12	104.00	53	3	168	204	0.280
Springfield, Mass., Combined Papers	70	3	12	235.20	76	8*	234	324	0.422
Westbury, Conn., *Republican*	70	3	12	69.60	63	4	188	160	0.200

* Seven retail outlets and one wholesale outlet.

After the completion of this experiment the officers devised the following plan, by means of which they not only obtained the names of dentists' patients who wore dentures but also in effect secured the dentists' recommendation of the powder to each recipient of the sample. First, in a letter to every dentist the officers described the use of Stera-Kleen and at the same time sent a 30-cent bottle for trial. Ten days later they sent a second letter telling the dentist of a plan which would benefit his patients and secure their goodwill. According to the plan, the dentist was to send in a list of his patients who wore dentures or removable bridges. The Phillips and Benjamin Company would then send each of these patients a vial containing a week's supply of Stera-Kleen and enclose with the vial a letter explaining the gift as follows: "We are glad to call your attention to Doctor Sherwin's Stera-Kleen and enclose a complimentary sample at the suggestion of your dentist, Dr. ...." All lists were kept confidential. The officers regarded the plan as successful. One out of every eight dentists filled out the lists, and the average number of names from each dentist was 42. The average cost of the promotional material sent to each dentist was 20 cents, or $1.60 for 42 names; thus the average cost for each name was 4 cents.

Later, instead of a letter to the dentists, the company employed "detail persons"[1] to call on the dentists, explain to them the advantages of Stera-Kleen, and obtain from them the names of patients who wore dentures. Officials were satisfied with the superior results achieved by this modification in the plan and believed that its success justified the additional expense. In one of the largest cities in the United States, for instance, a detail person in the course of a year secured names from one-third of the dentists; the cost averaged about $16 a week. In another large city a representative obtained 20,000 names of denture wearers from dentists in a period of nine weeks.

After reviewing the foregoing methods used for the promotion of Stera-Kleen, the officers, in 1935, came to the conclusion that sampling was a fundamental and necessary method of promotion for this product; but they could not agree on the advisability of supplementing the sampling program with local newspaper advertising. One officer was not in favor of this advertising, whereas

[1] "Detail person" is a term used in the trade to refer to people who call on doctors to explain and demonstrate merchandise.

another believed that the best way to establish a large volume of sales was to advertise locally in conjunction with a sampling program. All the officers, however, recognized that national advertising was desirable eventually but that it was out of the question until the company had established distribution.

The first officer, who was opposed to local advertising, stated that the program of sampling and distribution being carried on at that time was adequate to build up a satisfactory volume of sales and that, in view of the type of product, the increase in volume of sales resulting from local advertising would not justify the additional expense. He pointed out that manufacturers of toiletries regarded sampling as the most effective means of promotion for their products and that sales of Stera-Kleen had shown a marked increase with the methods then being used. He maintained further that, since Stera-Kleen would be used chiefly by people over 40 years old, part of the newspaper advertising would be wasted and consequently costs would tend to be excessive. At the same time, he emphasized the necessity of the company's providing wholesalers with stocks and of its making special introductory offers to retailers when it was conducting a sampling campaign in order to derive the full benefit from this method of promotion.

The second officer, who was in favor of advertising locally in conjunction with a sampling program, was convinced, on the other hand, that the company should immediately advertise in local newspapers in metropolitan cities, not only to supplement and support the sampling campaign but also to secure adequate distribution in such territories. In support of this point of view he referred to the fact that the company had no means of reaching a majority of denture wearers and that, although most dentists recommended Stera-Kleen, only one of every eight who were canvassed complied with the company's request and sent in a list of patients who wore dentures. Stera-Kleen, moreover, was a type of product which had not been publicized extensively. Consequently, advertising would serve to acquaint consumers with the advantages of Stera-Kleen and stimulate their interest in this kind of product before the samples were distributed.

The second officer pointed out that, despite the effectiveness of sampling in the promotion of a product of this kind, the influence of the sample was of short duration and that advertising was

important in keeping the consumer aware of the product. The recipient might fail to make use of the sample; or if he used it and was convinced of its merits, he might postpone purchase indefinitely without some further reminder. Advertising, moreover, would be indispensable in the event that a company with a competing product began a sampling campaign after samples of Stera-Kleen had been distributed. This official expressed the opinion that an advertising program was justified on the basis of inducing retailers to stock the product. An advertising program would assure the retailer that promotional efforts were being used to increase sales, whereas, even if a large number of samples were distributed in a city, few might reach the regular customers of an individual retailer.

That the initial costs for newspaper advertising would be high the second officer admitted, but he believed that the results would justify the additional expenditure. The lower initial cost of depending principally on sampling, in his opinion, was not an economy from a long-run point of view; for sampling, even on an extensive scale, did not give adequate coverage of the market and did not build up sufficient demand to justify a dealer's stocking the product. Newspaper advertising, therefore, appeared to be an essential preliminary before the company could realize the economies and other advantages of national advertising.

The second officer succeeded in securing the adoption of a program of advertising for New York City; and the advertising agency, which was in accord with his point of view, prepared copy for a series of advertisements in New York newspapers. The copy was of the news type, as shown in Exhibit 2, similar to that used with good results in small communities. The only difference was that the copy which had proved effective in small towns included the endorsement of a local druggist, whereas in New York, because of the size of the city, this endorsement was not feasible. The insertion of these advertisements, however, did not bring in any orders; and the officers decided that the absence of the endorsement was an important cause of the failure of the plan. The cost to the company for these advertisements and for window displays during the period amounted to approximately $7,000.

As a result of this campaign the first officer was convinced that his opinion with respect to local advertising had been justified;

but the second officer still maintained that the theory in regard to the advisability of local advertising had not been disproved by the New York campaign. He reminded the first officer that test

EXHIBIT 2
PHILLIPS AND BENJAMIN COMPANY
Advertisements Used in New York Campaign

STERA-KLEEN, AMAZING NEW DISCOVERY, CLEANS FALSE TEETH WITHOUT BRUSHING

Stera-Kleen was developed after many years of laboratory research and clinical test. Daily use of this remarkable product removes all stains, tartar, mucin, from false teeth, and is absolutely harmless. It penetrates into the tiniest crevices, even into the pores of the material from which your denture is made, removing decomposed food and other damaging foreign matter which a brushing could never reach.

Stera-Kleen leaves the mouth cool and refreshed and the plates smooth to the tongue. The Stera-Kleen Company invite you to speak to your own Dentist about this amazing product. For Stera-Kleen has the highest professional endorsement.

Try this wonderful new scientific product today. It will bring new mouth health, new attractiveness, new comfort, to all wearers of removable plates and bridges. Get a package of Stera-Kleen today. 30c or 60c at all good Drug Stores. Ask your druggist about the money-back guarantee on the Stera-Kleen. —Advt.

CLEAN FALSE TEETH NEW WAY AND HELP AVOID SERIOUS TROUBLES

A leading Dentist who had had much experience with troubles resulting from improperly cleansed false teeth, searched for a cleansing agent that would not only remove filthy, germ-breeding accumulations but ELIMINATE TARTAR which so often causes irritation.

He approached the problem from a different angle, studying first the very chemistry of mucin and tartar, and finally developed Stera-Kleen, a product of scientific formula made especially for denture cleansing. Used daily, Stera-Kleen removes all stains, eliminates tartar and mucin entirely — ALL WITHOUT BRUSHING. Stera-Kleen penetrates where brushing never reaches.

Stera-Kleen has behind it a solid wall of laboratory and clinical approval. It is absolutely harmless. Leading Dentists endorse it without qualification. Ask your Dentist.

Try Stera-Kleen today. Know the healthfulness, the delightfulness of a scientifically cleansed dental plate or removable bridge. Get your package of Stera-Kleen today, 30c or 60c, at all good Drug Stores. Ask your Druggist about the money-back guarantee on Stera-Kleen.—Advt.

campaigns had demonstrated that advertising the product had been successful in building up sales volume. In his opinion, the most recent experience only served to show the importance of and

necessity for the right kind of copy. He believed, therefore, that a change should be made in the buying appeals to be featured in the advertisements of Stera-Kleen. The convenience of not having to brush the dentures and the exceptional cleansing properties had been the appeals stressed as the major factors in inducing consumers to use Stera-Kleen. On the basis of the successful results from a series of advertisements in Florida newspapers, he advised trying the type of advertising which emphasized the appeal that Stera-Kleen removed stains from dentures.

The second officer urged that the company immediately undertake in Philadelphia a promotional campaign consisting of sampling and newspaper advertising, and that it use copy of the type which had been tested in Florida. He proposed that the company insert a 50-line advertisement, of the type shown in Exhibit 3, three times a week for one year in the *Philadelphia Bulletin*. At the rate of 62½ cents a line, the total cost of these advertisements would be $4,875. The *Philadelphia Bulletin* had a circulation in excess of 500,000 daily, which, in the officer's opinion, would give a reader circulation of 1,500,000, or about 45% of the total population in the Philadelphia trading area. On the basis of experience he estimated that among these readers there would be 300,000 wearers of dentures, all of whom would be prospective customers.

The company's advertising, together with a sampling campaign, was expected to induce at least 10% of the prospective customers in Philadelphia to purchase at least three 60-cent bottles in a year, or a total unit sales volume of 90,000 bottles. In its sampling campaign the company would depend on letters to dentists to secure lists of patients who wore dentures. The second officer assumed that, of the 1,560 dentists in Philadelphia, 200 would furnish 40 names apiece, or 8,000 names. Samples would be sent to each of these persons and also to any persons who requested samples as a result of the advertising. Because of lack of experience, the management could make no reliable estimate of the number of samples which would be requested; the minimum estimate of the samples which would be distributed during the year was 12,000. At a cost of 5 cents a vial, the total cost of samples would be $600; therefore the minimum cost of the promotional campaign would be approximately $5,500. With sales of 90,000 bottles, the promotional expense for each bottle sold would be about 6.1 cents. In view of the opinion of the management that an allowance of

10 cents on each 60-cent bottle for promotional expense was not excessive, the second officer believed that these estimates appeared to justify the undertaking.

The first officer opposed this plan and criticized it not only on the general principle that local advertising was futile for this type of product but also on the specific ground that the estimate of sales was too high. He reiterated his conviction that the company

EXHIBIT 3
PHILLIPS AND BENJAMIN COMPANY
Samples of Proposed Advertising for Philadelphia

should concentrate its efforts on enlisting the support of the dental profession and in securing the dentists' recommendation of the product to patients. Although the public interest in dental hygiene had been aroused by the extensive promotional campaigns of manufacturers of toothbrushes and cleansing preparations for natural teeth, wearers of dentures, for the most part, were not aware of the difficulties in achieving absolute cleanliness of dentures and of the importance of maintaining the precision of the ridges of the dentures. The explanation of the technical advantages of Stera-

Kleen by a dentist, this officer asserted, would be the most satisfactory and the most convincing means of securing permanent users.

In the opinion of the first officer, the company's promotional plan of employing detail persons to secure lists of names from dentists and then of distributing samples of Stera-Kleen with the dentist's name on them to patients was more economical than an advertising campaign. A detail person could be hired for about $16 a week, and in the course of a year should be able to secure lists from at least a third of the dentists in Philadelphia. A conservative estimate of the number of names which could be obtained from each dentist was 40, or a total of 20,000. With the dentists' recommendation, 80% of these prospective customers might be expected to purchase at least three 60-cent bottles during the year; in this way a unit sales volume of at least 48,000 bottles probably would be achieved. The cost of samples to the dentists' patients would be $1,000, and the salary of the detail persons would be $832, or a total of $1,832. Thus promotional costs for each bottle sold would be approximately 3.8 cents in contrast to a cost of 6.1 cents for the proposed campaign of advertising and sampling.

The first officer also believed that the estimate of possible sales volume made by the second officer in connection with his advertising proposal was too large. The first officer maintained that Stera-Kleen would attract only fastidious persons, and that of the estimated 300,000 wearers of dentures only 10%, at most, would be prospective customers for Stera-Kleen. Even if the campaign were effective in inducing 75% of these prospective customers to purchase three bottles, the total volume of sales resulting from this campaign would be only about 67,500 bottles of the 60-cent size. He stated that 48,000 unit sales at an out-of-pocket cost of $1,832 were better than 67,500 unit sales at a cost of $5,500. He agreed with the second officer that, if local advertising were undertaken, the right type of copy was essential; and he admitted that a limited use of advertising might be desirable to remind customers of the product.

In reply the second officer conceded that promotional expenses under his plan might be higher per unit, but he maintained that the greater volume of sales even at the lower estimate would give a larger aggregate income. He calculated, for instance, that gross income on 67,500 bottles of the 60-cent size with a gross

margin of 20 cents a bottle would be $13,500. Expenses for the proposed campaign would be $5,500, and the net contribution to other expenses and profit, $8,000. By depending only on a detail person, the company probably at the most would have a sales volume of 48,000 bottles of the 60-cent size, or a gross income of $9,600. After deducting $1,832, the minimum available for other expenses, net income would be $7,768. In view of the differential in estimates for total aggregate income, he believed that the program as he had planned it should be carried out in Philadelphia.

What part should advertising have played in the promotional program for Stera-Kleen?

3. NUGENT HAT COMPANY

DEALER COOPERATIVE ADVERTISING IN NEWSPAPERS

Early in November, 1938, the officials of the sales and advertising departments of the Nugent Hat Company were considering a plan to abandon all dealer cooperative advertising in local newspapers and to concentrate on advertising in national magazines. This proposal was made in the course of the annual meeting held for the purpose of deciding on the advertising budget for the following year.

The Nugent Hat Company, located in Providence, Rhode Island, was an old established firm, which had manufactured men's high-grade hats for many years. By 1938 the company had total assets of $4,328,715 and net sales of $6,378,182 (see Exhibit 1).

The high quality of the Nugent hat resulted from the use of high-grade materials and from expert workmanship, as well as from a patented process of manufacture which provided greater wear resistance and permanence of form. Nugent hats were made in a large number of different styles and colors and were priced to retail at $5, $7.50, $10, and $20. Retailers were allowed discounts of 40% off these prices.

The Nugent Hat Company manufactured a new line of hats for each of the three major selling seasons of the year: spring, summer, and fall. Sales in the spring season were heavily concentrated in March and April. For this season the company

produced a line of light- and medium-weight hats. For sale in the summer season, which included late May, June, and early July, the company manufactured a line of straw hats. The fall season ran from September through November, and a line of regular-weight hats was produced for this season. Sales were highest in the spring and fall seasons. January and February were usually the low point for the entire year.

EXHIBIT 1
NUGENT HAT COMPANY
Net Sales and Net Income, 1927 through 1937
(Years Ended October 31)

Year	Net Sales	Net Income
1927	$4,811,178	$611,881
1928	5,607,352	546,353
1929	6,829,987	301,393
1930	5,335,817	355,603‡
1931	2,694,061	588,388‡
1932*	534,695	142,550‡
1932†	1,559,263	195,866‡
1933	3,446,971	133,307
1934	4,376,033	370,831
1935	5,033,803	467,634
1936	5,799,451	553,987
1937	6,378,182	397,418

* Four-month period ended February 29.
† Six-month period ended October 31.
‡ Deficit.

Nugent hats were sold by company salesmen direct to retail chain stores and to independent retail outlets. In general, the Nugent Hat Company followed the policy of granting exclusive agencies to retailers who handled the Nugent line, although an exception was made to this policy in the larger cities. Thus the company was represented in the smaller cities by only one Nugent dealer, in the larger cities by two or three outlets, and in New York City by five outlets. In 1938 there were approximately 2,500 retailers, located in 1,000 cities throughout the United States, who sold Nugent hats.

The Nugent Hat Company had granted exclusive agencies for 20 years. This policy had been adopted, and was continued, because dealers preferred to have exclusive rights to the Nugent brand, a situation which enabled each of them to control the promotion in his local market without concern over what some other

retailer might do. A dealer running a high-class shop would be likely to feel that his prestige was lowered if stores with poor reputations were able to sell the same brand of hat.

For a period of 20 years prior to 1938 the Nugent Hat Company had made a practice of sharing the cost of local advertising over the dealer's name. Until 1927 such advertising, together with dealer sales helps, had constituted the company's entire advertising program. In that year, however, the company had added national magazine advertising to its program; and this promotion had constituted an important part of the company's advertising effort in that year and in subsequent years.

According to the advertising manager, in 1938 the major promotional tasks of the company were: (1) to increase the total sales of hats, (2) to persuade prospective customers to favor Nugent hats whenever the need for a new hat arose, and (3) to help move Nugent hats off the dealers' shelves. Increasing the sale of hats was the most important problem of the company. For a number of years prior to 1938 there had been a tendency among young men to go bareheaded on most occasions. In addition, many men who wore hats did not consider them an important part of their attire. As a result, these men paid little attention to the condition of their headgear. They wore their hats for a long time, and they usually replaced other items of clothing before buying a new hat. In contrast to this existing situation, the officials of the company wanted to induce men to buy a new hat at least three times a year. They believed that promotional effort should be directed primarily to this end.

Inasmuch as there were a number of competing brands of hats on the market, however, promotional effort could not be wholly confined to increasing the sale of hats. The executives believed that it was essential to persuade the prospective buyer at least to consider, if not to prefer, a Nugent hat when the time came to replace his old hat.

The third task was to help move Nugent hats off the dealers' shelves. A dealer who purchased Nugent hats and then found it difficult to sell them did not repurchase the brand the next time the Nugent salesman came round. When Nugent salesmen called on dealers, they were frequently asked the question, "What kind of advertising and promotional assistance is the company going to provide in order to help us move Nugent hats off our shelves?"

In determining the advertising appropriation, company officials applied a fixed percentage to estimated sales volume. Through past experience these officials believed that the advertising expenditure should be 5% of total dollar sales. The company could not afford to spend more than this amount and still meet competitive prices. On the other hand, this percentage was large enough to provide what company officials believed to be an adequate advertising program. The estimate of sales volume was based on the actual sales for the previous year, with an adjustment up or down to allow for changes in purchasing power. At the end of six months, however, the advertising appropriation which had been set up at the beginning of the fiscal year was revised in accordance with the actual sales volume for that period and the outlook for the remainder of the year.

In 1938 the advertising appropriation of approximately $300,000 was divided among magazine advertising over the company's name, dealer cooperative newspaper advertising, and dealer sales helps. In distributing the advertising appropriation the procedure was as follows: (1) The amount to be spent for dealer cooperative advertising was determined by a trial and error method. Over a period of years the company had found that such advertising tended to average about 2% of sales. This experience provided a basis for setting up a budget figure. The amount of dealer cooperative advertising actually placed, however, depended on the decisions of the individual dealers as to whether and how much they wanted to advertise (within the maximum limit set by the advertising allowance). Because of this fact, it was recognized that a revision of the budgeted figure might be necessary as the year progressed. (2) The company followed the practice of allocating as much money for magazine advertising as its funds would permit. (3) The balance of the appropriation was spread as far as possible in dealer sales helps, some point-of-sale help being required to tie in with each promotional idea featured in magazine advertising.

According to the advertising manager, each of the foregoing types of advertising played a part in helping to make a sale. In his opinion, a man would not purchase a Nugent hat until he had been influenced to do so from five or six different sources. Therefore, it was desirable that the man should hear about the product from conversation with users, that he should be familiar with the

brand name, and that he should see references to the product in several different places. Hence the company used magazine advertising, cooperated with dealers in local newspaper advertising, and provided direct-mail material and window-display material for the dealers.

Consumer advertising over the company's name in 1938 was confined to national magazines such as *Esquire*, *Collier's*, *Time*, or *The Saturday Evening Post*. In this advertising the primary emphasis was placed on the new hat styles being featured by the Nugent Hat Company. By picturing new styles, by skillful use of illustration and color, and by the tone of the copy, an air of smartness and style leadership was conveyed to readers. In its advertising copy the company stressed the distinctive features of its hats and explained their advantages to the wearer. (The text of a typical magazine advertisement was as shown in Exhibit 2.)

EXHIBIT 2
NUGENT HAT COMPANY
Text of a Typical Magazine Advertisement

NUGENT AUTUMN MIXTURES

Mastery of the fine art of hat-making meets the eye in every detail of NUGENT Autumn Mixtures. There is handsome, wholesome ruggedness in the texture—attractive glints of woodsy plumage in the colorings. Note particularly how the new Nugent Edge, a smart new style feature in its own right, also serves a highly practical purpose. It holds the brim in shape, regardless of the contour of the head that wears it.

NUGENT
Representatives in Fine Stores Everywhere

In the opinion of the advertising manager, the chief function of the national magazine campaign was to provide reminder advertising. In addition, however, this advertising, particularly the space taken in *Esquire*, assisted Nugent salesmen in persuading dealers to stock new hat styles and also provided selling points for the use of retail salesmen. The advertising manager felt that *Esquire* had done a good job of making men more style conscious and that the influence of this magazine made it a good medium for advertisers of men's wear. Experience had shown that Nugent salesmen could get dealers to order a given hat on the strength of the statement that the hat was to be featured in *Esquire*. The fact that a certain Nugent hat was featured in *Esquire* provided the retail salesman with a sales point and influenced him to try

to sell the Nugent hat in preference to another brand carried in stock. Investigation indicated that the retail clerk was usually at a loss for sales talk during the process of selling a hat. If a Nugent hat was featured in *Esquire* the clerk could say, "Would you like to try on this Nugent hat? It is one which Nugent is featuring in *Esquire* this month. According to recent reports, it is very popular in New York."

Local advertising in cooperation with retailers was confined to newspaper space only. The company offered to pay half the net cost of the newspaper space used by dealers to advertise Nugent hats, up to a total amount not to exceed 5% of the net sum of the dealers' shipments during a given year. The newspaper advertising of a Nugent dealer served the purpose of telling prospective customers where they could buy Nugent hats, and at the same time it tended to stimulate them to come into the store. (See Exhibit 3 for a copy of the text of an advertisement run by the Chicago dealer of the Nugent Hat Company in October, 1938.)

EXHIBIT 3
NUGENT HAT COMPANY
Text from Advertisement of Chicago Dealer
in the *Chicago Tribune*, October, 1938

NEW WIDE BRIM NUGENT HATS
$5

Men with a sure sense of style appreciate the definite personality value of these new Nugent hats with their wider brims and tapered lower crowns. There is perfect balance together with the new smartness in these brand new arrivals. Unusual values at this new low price.

THE ONLY COMPLETE LINE OF NUGENT HATS IN CHICAGO
AMES & DEWEY
Michigan at Jackson

According to the advertising manager, the maximum advertising allowance of 5% of net shipments was established by making a study of retailers' advertising expense ratios from such retail operating expense surveys as those published by the Harvard Bureau of Business Research.

Under the 1938 program, the placement by dealers of local newspaper advertising in cooperation with the Nugent Hat Company was entirely voluntary. On this basis, during 1938, approximately 350 of the 2,500 Nugent dealers placed advertisements under the cooperative advertising plan. The total cost of dealer

cooperative advertising to the Nugent Hat Company amounted to approximately 2% of total net sales.

The company provided additional assistance to its dealers in their local advertising by furnishing, without cost, cuts and mats and ready-made advertisements. These materials were pictured and described in the dealers' advertising portfolios which were carried by Nugent salesmen on their visits to retail stores. For instance, the fall and winter portfolio for 1938 presented for dealer use six fall promotions:

July—Lightweight Felts
August—University Series
September—Special Nugent Features
October—Sports Hats
November—Nugent Autumn Mixtures
December—Christmas Gift Promotion

For each of these promotions the portfolio pictured a set of company-prepared advertisements which could be secured by the dealer free of charge. The dealer had the option of taking either the complete advertisement or the illustration only. (The text of a typical advertisement prepared by the company for dealer use was as shown in Exhibit 4.)

Exhibit 4
Nugent Hat Company
Text of Advertisement
Prepared by the Company for Dealer Use

A NEW TOP IN STYLE
BY NUGENT

Style theme of the year, a tailored symphony composed by Nugent, is the new "fore and aft" rig of these superfine felts. The narrowed peak snaps down without any suggestion of over-fullness. Widening astern, it swirls up in a graceful streamline. The new Nugent Edge, an exclusive finish achieved by sheer genius of the hatter's art, skillfully and lastingly holds this line against the distorting tendencies of irregular head shapes. The crown is tailored also, to achieve the low, spread-back that is currently the ideal of young-dressed men.

DEALER'S NAME

In addition to the material described above, the company provided its dealers free of charge with window-display cards, around which displays could be built. Photographs of suggested window displays were sent to retailers in order to provide them with ideas which could be adapted to their own use. These display cards

included some which were planned to coordinate with the monthly promotions suggested for dealer use, and others which served to tie in the local advertising and promotional efforts with the advertisements which appeared in national magazines. This latter type of card presented reproductions of advertisements scheduled to appear each month in the national magazines. Dealers were notified in advance of the appearance dates of the advertisements in order that they might correlate their window displays with the national advertising.

As an additional means of tying together the local and national advertising, the company prepared for its dealers booklets to be used as statement enclosures. These booklets, furnished at a small charge, contained reproductions of advertisements from the national campaign.

During the year 1938 the Nugent Hat Company spent 55% of its advertising appropriation for national magazine advertising, 40% for dealer cooperative newspaper advertising, and 5% for dealer sales helps.

As evidence of the effectiveness of this type of advertising program, the advertising manager estimated that the following degrees of brand familiarity had been developed among consumers:

Consumer Acceptance	100%
Consumer Recognition	85
Consumer Preference	25
Consumer Insistence	5

He stated that the extent to which consumers had a knowledge of where they could buy Nugent hats depended on the volume and effectiveness of dealer local advertising and window display and that no generalizations could be made on this point. Similarly, the extent to which this advertising program produced immediate results in the form of sales depended on the amount and effectiveness of dealer local advertising and window display.

In October, 1938, the Kendall Hat Company, a leading competitor, announced a plan to eliminate dealer cooperative advertising and to confine advertising effort to national magazines. In contrast to the Nugent Hat Company, the Kendall company did not grant exclusive agencies to the dealers who handled its products. In consequence, the distribution of Kendall hats was much less restricted than that of Nugent hats.

The announcement of the action of the Kendall Hat Company caused the sales and advertising executives of the Nugent Hat Company to reexamine their own advertising policy. Consequently, when these executives met early in November, 1938, to discuss the 1939 advertising budget, the question was raised as to whether the company should continue its policy of allocating 40% of its advertising appropriation for local advertising placed in cooperation with dealers. One of the executives proposed that the company eliminate dealer cooperative advertising entirely and concentrate all expenditures on advertising in national magazines. By eliminating dealer cooperative advertising the company would have more funds to devote to national magazine advertising. Hence it would be possible to make consumers more conscious of Nugent hats. Moreover, the opinion was expressed that it was the dealer's job to do the local advertising necessary to capitalize on the demand created by the national magazine advertising of the Nugent Hat Company. Again, inasmuch as many of the Nugent dealers had been handling Nugent hats for many years, there was not the same necessity for local advertising to tell people where the brand could be purchased as had existed during the early years of the business. A man who had bought one hat from the Nugent outlet in Chicago would know where to go to buy the Nugent brand. When he wanted to buy another hat, he would probably go back to the same store, provided he had been well treated and had been satisfied with his previous purchase.

On the other hand, a sales official stated that the plan of requiring the dealers to bear the entire cost of the local advertising could be carried out successfully only if the Nugent Hat Company did such an outstanding job in its national magazine advertising that the dealers would be glad to run local advertising at their own expense in order to get the benefit of the demand stimulated. In the opinion of this official, magazine advertising expenditures would have to be increased by at least 200% in order to produce such a result. An increase of 200% in magazine advertising expenditures for 1939 would have to be taken out of profits, it was conceded, inasmuch as the national magazine advertising could not be expected to bring immediate results. Certain officials were skeptical as to whether an enlarged magazine advertising campaign would expand sales volume, even ultimately.

One of the sales officials believed that if the proposed plan were put through, dealer advertising would probably stop. If dealers

placed the same amount of advertising that they would normally place under the dealer cooperative plan, their advertising costs would be doubled. If they spent the same number of dollars on advertising that they had spent before, the elimination of cooperative advertising allowances would result in decreasing the amount of local advertising by at least one-half. In the opinion of the advertising manager, the elimination of dealer cooperative advertising would result in a decline in the extent of aggressive sales promotion and retail salesmanship put behind the Nugent brand.

It was thought that the typical retailer would prefer 200 lines of space over his own name in his local newspaper to a half-page advertisement by the company in *The Saturday Evening Post.* The mere fact that his name appeared in the newspaper led him to favor local advertising over national magazine advertising. The retailer reasoned that the local advertisement which appeared over his name was going to bring hat business into his own store. Furthermore, he carried other merchandise in his store that he wanted to sell.

What action should the company have taken on the proposal to eliminate dealer cooperative advertising in newspapers?

4. MORRO TOBACCO COMPANY

RADIO ADVERTISING PROGRAM

In 1935 the Morro Tobacco Company of Louisville, Kentucky, decided to advertise Stag long-cut tobacco, a product which had not previously been promoted. This decision was the third step in a plan which had been developed in order to offset the unfavorable trend in the sales of smoking and chewing tobaccos, products which had accounted for approximately two-thirds of the company's output in 1933. The other lines of action followed had been (1) the decision, in 1933, to manufacture and market a new brand of pipe tobacco and (2) the introduction, in 1935, of a new brand of cigarettes.

From the founding of the Morro Tobacco Company in 1900 until 1934, smoking- and chewing-tobacco products had been the most important part of the company's output. In 1933, these products represented approximately two-thirds of the sales of the

company; the remaining third consisted of scrap tobacco and cigar clippings, together with fine-cut chewing tobacco and snuff. The company had several cigarette brands, but they made a negligible contribution to total volume. No smoking mixtures were manufactured at that time. Because the company depended primarily on smoking- and chewing-tobacco products for its volume prior to 1934, the characteristics of this type of tobacco and the trends in its consumption were important factors in the history of the company.

Long-cut tobacco had been developed in the 1880's by James B. Duke, who was then in charge of the New York branch of W. Duke & Sons. The need which this product filled grew out of the tobacco-consumption habits of the workingman of this period. It was then a rule in most industrial concerns to prohibit smoking during working hours. Consequently, the habitual users of tobacco had adopted the custom of chewing tobacco while on the job and of smoking pipes before and after working hours. This practice made it necessary for the workingman to keep himself supplied with two products: a package of smoking tobacco and a plug of chewing tobacco. It was in this situation that James B. Duke saw the need for a new type of tobacco product which could be used for both chewing and smoking. Accordingly, he developed the "long-cut" type of tobacco, made from a strong, full-bodied tobacco leaf. Since it was cut into long shreds, the product was suitable for a pipe tobacco and was also in a form satisfactory for chewing.

James B. Duke saw a big future for this type of product and introduced it in the principal cities with what was described as a "huge" publicity program. His belief in the product was justified, for long-cut tobacco soon became very popular in the industrial and mining sections of the country. Its use grew from the time of its introduction until the beginning of the First World War period, when the peak was reached. Not only was this product convenient for both smoking and chewing, but also its strong, full-bodied flavor was popular with the robust, immigrant type of worker. Moreover, during this period, consumers in general preferred their tobacco in a form for chewing or for smoking in a pipe; the cigarette had not yet become the popular form of tobacco that it was later to be.[1]

[1] According to *Competition in the American Tobacco Industry*, by Reavis Cox (New York, Columbia University Press, 1933, p. 44), 68.7% of the tobacco leaf used in registered factories in 1910 went into smoking and chewing tobacco and snuff, 24.7% into large cigars, 5.6% into small cigarettes, and less than 1% into small cigars and large cigarettes.

But this favorable situation was not to continue. Gradual changes in living and working conditions throughout the United States resulted in a growing proportion of less robust, white-collar workers. These people, because of their living habits, came to prefer a type of tobacco milder than that which their fathers had used.

Still another factor operating against the use of long-cut tobacco was the growing preference for the cigarette as against the pipe or the plug of chewing tobacco. The development of the "blended" cigarette in 1913 provided a smoke which appealed to the popular taste. This change in taste received its greatest impetus during the First World War. Cigarettes were much more convenient for soldiers' use than other types of tobacco products. Also, people were encouraged to send cigarettes to the men in the camps. The consumption of cigarettes began to increase at a phenomenal rate during this period, whereas the use of smoking tobacco and chewing tobacco began to show a declining trend. The president of the Morro Tobacco Company estimated that the consumption of long-cut tobacco in the United States in 1937 was only half as great as it had been before the First World War. Percentage changes yearly in sales by pounds of a typical long-cut brand of Morro tobacco from 1928 through 1934 had been as follows:

1928	− 0.6%
1929	+ 4.0
1930	+ 1.0
1931	− 2.6
1932	−10.0
1933	−16.0
1934	−13.0

In the opinion of the sales manager, the serious decline in sales of this product in 1932, 1933, and 1934 had resulted from the business depression which started in 1929, as well as from the trend away from the use of long-cut tobacco. By 1935 it had become apparent to the company that the business recovery which was gaining momentum at that time would not cause enough improvement in the sales of long-cut tobacco to bring this part of the business back to 1928–1929 levels. Although in 1935 the company was experiencing considerable success in the promotion of its Bluegrass tobacco, a mild, straight smoking tobacco, the management believed that something should be done to increase long-cut tobacco sales

to predepression levels. Accordingly, for the stimulation of the long-cut tobacco business a plan was adopted which included the following parts: (1) the selection of one outstanding long-cut brand for sales promotional work, (2) a thorough investigation of this brand to determine how well it met consumers' desires when compared with competing products, and (3) a campaign of radio advertising to stimulate the demand for this brand.

As the first step in the program Stag Smoking & Chewing Tobacco was selected as the brand on which to concentrate the sales promotion effort. The Stag brand was well established and was considered a leader in its field; but in common with other long-cut brands, it had shown some decline in sales by pounds from 1930 to 1934, as follows:

1930	607,253
1931	596,442
1932	519,382
1933	470,934
1934	509,435

The next question to be settled was the reaction of consumers to the Stag brand of tobacco. In order to determine consumer preferences, the Morro company sent a man into the state of Wisconsin to make a study of the sales of smoking and chewing tobacco by Wisconsin jobbers. In the course of the survey, which took 30 days, 44 jobbers were called on. From each jobber the following information was secured: the names of the brands of smoking and chewing tobacco handled, the sizes of packages of each brand carried in stock, the retail price for each size, the number of ounces of tobacco in each size, and the sales by size of package for each brand. When these figures had been summarized, the sales manager had data on sales by brands, by prices, and by sizes of package, which were useful in determining consumer preferences. Prior to 1935, Stag tobacco had been sold in three packages: a 10-cent size, containing 1⅝ ounces of tobacco; a 35-cent half-pound size, containing 7 ounces of tobacco; and an 80-cent pound size, containing 14 ounces of tobacco. After making an analysis of the data collected in the Wisconsin investigation, the sales manager decided to make two changes in the Stag packages. The first change was to reduce the quantity of tobacco in the half-pound package from 7 ounces to 6, to reduce the wholesale list price from $3.84 per dozen to $3, and to wrap this package in cellophane.

This package then could be sold at a retail price of 30 cents. The second change was to reduce the wholesale list price of the pound package from $8.40 to $7.50 per dozen. This change would make it possible for the retailer to sell the package at 75 cents instead of 80 cents.

In the opinion of the sales manager, these changes were very important. The investigation had disclosed the fact that the larger packages of Stag tobacco were not getting their share of the market. The half-pound package was out of line with competing brands, both with respect to the quantity of tobacco in the package and with respect to price. The price of the pound package was above competitive prices for the same size of package. The changes made placed the Stag brand on a more fully competitive basis.

The third step in the company's plan to increase its sales of long-cut tobacco was to undertake an advertising campaign for the Stag brand. Continuing the policy adopted when Bluegrass tobacco had been introduced, the sales program placed primary emphasis on advertising and very little emphasis on the use of salesmen. The sales manager estimated that, out of total selling and advertising expense, personal selling expenses would amount to 20% and advertising expense to 80%. The company decided to advertise Stag tobacco over the radio. Although radio advertising had never before been tried for long-cut tobacco, at that time the company was meeting with considerable success in its advertising of Bluegrass tobacco by this same medium. Previous attempts at newspaper and billboard advertising for this product had failed.

The company requested its advertising agency, Juke & Elder, Inc., to recommend a program for Stag tobacco. The agency first suggested a news commentator who would broadcast from three to six times a week, but the advertising manager of the company believed that the man selected as the commentator would not be popular. He felt that this man was a "high-brow" and that the program would not appeal to the potential customers for Stag tobacco. Accordingly, a different type of program was planned, featuring Jack Davis and the Stag Rhythm Rascals. Jack Davis was very popular in the Milwaukee territory; he had just won a contest as the most popular announcer in the state. The program which was developed included music by the Rhythm

Rascals and funny stories by Davis. It was described by the advertising manager as "a good, low-level, earthy program."

This program was broadcast for 15 minutes three times a week over radio station WTMJ, Milwaukee, starting on January 20, 1936; radio station WTAQ, Green Bay, was added in May, 1937. The cost of the program amounted to $1,000 a month until the second station was added, when the cost increased to $2,000 a month. Excerpts from the script of a typical program follow.

June 9, 1937

Announcer: Presenting . . . Jack Davis and the STAG Rhythm Rascals . . . coming full steam ahead through your loudspeaker with music and song in honor of STAG . . . for over thirty years the favorite smoking and chewing tobacco in this territory . . . and here's Jack himself to ask:

Davis and Music: (*Opening theme*)

Davis: Today we continue our advice to June Brides and Bridegrooms . . . The subject for today is "How to Avoid Quarrels" . . . (*chuckles*). Maybe you happy love-birds think you NEVER WILL quarrel . . . but someday you'll be talking about something . . . such as "How to Avoid Quarrels" and first thing you know you'll be quarreling . . . Always remember . . . A contented person never quarrels, so BE CONTENTED . . . June brides, to keep your husband contented, get him started smoking a pipe! . . . That always brings contentment . . . June bridegrooms, to keep your bride contented . . . see that you smoke good old STAG tobacco in your pipe . . . She'll go for that aroma just as you go for that swell taste! . . . Mark down this prescription . . . Whenever you feel a quarrel coming on, light your pipeful of STAG, draw in that mellow, rich-tasting smoke and let the fragrant aroma drift over the room . . . Get a package of STAG today and practice up on contentment!

Music: (*First number*)

Davis: (*Gags*)

Music: (*Second number*)

Davis: Today our guest in the studio is Brother______of local______of the______union . . . Brother______, do you prefer a large-size pipe or a small-size pipe?

Guest: (*Ad libs answer*)

Davis: Do you think it makes any difference in the taste?

Guest: Jack, any pipe tastes fine when you've got STAG in it . . .

Davis: You said it, Brother______.

Guest: I've been smoking STAG for about______years and I don't think there's a better tobacco anywhere . . .

Davis: You look like you know your tobacco, all right . . .

GUEST: Well, I'm no expert, Jack, but I know what's good . . . The fellas who make STAG are the real experts . . .

DAVIS: You betcha . . . Every one a union man . . .

GUEST: Yes sir, that union label means expert workmanship and first-rate materials from start to finish . . . I tell you, it sure does make a better product all around . . .

DAVIS: Absolutely . . . Now let's hear about you . . . for your initiation into the Grand Elegant Order . . . Got a hobby . . . or a favorite sport?

GUEST: (*Tells briefly about hobby or favorite sport*)

DAVIS: That's fine . . . You're now a full-fledged member of the Grand Elegant Order of STAG . . . Your duty now will be to introduce more men to the world's greatest tobacco . . .

GUEST: I'll do that, all right, Jack . . .

DAVIS: Thanks a lot for coming up today, it's been a lot of fun, etc. . . .

MUSIC: (*Third number*)

DAVIS: (*Gags*)

MUSIC: (*Fourth number*)

DAVIS: Here's a swell letter from______of Milwaukee, Wisconsin . . . Brother______says, quote: I have six pipes now and with STAG tobacco and one of these pipes I have an enjoyable evening . . . unquote . . . You bet your boots, the more pipes the merrier . . . and the better the pipe the better the smoke . . . That's why Brother Willoughby Taylor, America's greatest tobacco expert, sat himself down and designed a fine pipe . . . a thorobred pipe . . . that every one of you men can have . . . Brothers in the Grand Elegant Order, gather 'round the loudspeaker, uncork your ears and listen to this . . . EVERY STAG COUPON tells how easily you can get a Willoughby Taylor briar pipe for yourself! . . . There's one coupon in the ten-cent size, four in the thirty-cent size, and EIGHT coupons in the big pail! . . . Ask for STAG tobacco today and start right after your new pipe! (*Gags to close*)

DAVIS AND MUSIC: (*Closing theme*)

ANNOUNCER: Listen Friday at this time for another meeting of the Grand Elegant Order with Davis and the gang . . . whooping it up in honor of STAG long-cut smoking and chewing tobacco . . . BLUEGRASS fine-cut tobacco for pipes and cigarettes and the new GOLD LABEL NAPOLEON cigarettes!

The results of the advertising campaign were as indicated in Exhibit 1. The total sales of Stag tobacco for the first six months of 1936 showed an increase of 9.4% over the same period in 1935; the total sales for the last six months of 1936 showed an increase of 13.8% over the same period in 1935; while the total sales for the first six months of 1937 increased 26.9% over the first six months

of 1936. The downward trend in the sales of Stag tobacco appeared to be broken.

Prior to the time when the Morro Tobacco Company began the Stag advertising campaign, the largest sales volume secured in any one month had been recorded for October, 1929. In that month the sales had amounted to 58,636 pounds. A new monthly sales record, however, was set for this brand when in May, 1937, after approximately a year and a half of radio advertising, a total of 60,858 pounds of Stag tobacco was sold.

EXHIBIT 1
MORRO TOBACCO COMPANY
Sales of Stag Long-cut Tobacco, by Months, 1935–1938
(In pounds)

Month	1935	1936	1937	1938
January	42,850	42,405*	46,960	54,904
February	35,217	40,676	49,205	50,733
March	38,458	40,956	58,616	58,424
April	37,273	43,494	54,841	57,655
May	47,259	43,429	60,858	68,264
June	37,819	50,267	60,934	60,863
	238,876	261,227	331,414	350,843
July	46,380	46,271	60,660	60,381
August	40,199	46,326	58,086	61,178
September	44,326	50,701	59,650	58,929
October	47,091	49,660	52,492	56,979
November	39,140	51,782	64,212	61,062
December	42,938	51,141	59,791	57,257
	260,074	295,881	354,891	355,786
Total for Year	498,950	557,108	686,305	706,629

* Advertising started on January 20, 1936.

Toward the end of 1938, however, increases in sales over corresponding months of the previous year did not develop; and early in 1939 there were considerable decreases in sales. The management believed that these decreases might be attributable to either or both of two potential causes: (1) The radio program perhaps had ceased to be as effective as previously; and (2) the declining trend for long-cut tobacco possibly was again in evidence.

What action should the management have taken?

5. BIG BEAR MARKET COMPANY

USE OF RADIO ADVERTISING

In April, 1940, a salesman from one of the Boston radio stations approached Mr. Hanson, president of the Big Bear Market Company, with a suggested program to advertise the supermarket over the radio. In the spring of 1939 the company had tried some radio advertising, which Mr. Hanson had not considered successful; but since the suggested program was of a different nature from the 1939 program, Mr. Hanson agreed to give careful consideration to the possibilities of using this form of advertising.

The Big Bear Market, the oldest supermarket in New England, did an annual business of about $2,500,000. The store occupied the first three floors of a well-built, four-story building, formerly a factory. The building had a railroad siding and was only a few miles away from Boston, an important food distributing center. The store's parking facilities, which included one section rented for $50 a month, accommodated more than 1,000 automobiles. Over 500,000 people resided within 2½ miles of the store, and there were a number of cities and residential suburbs within a radius of 10 miles; two main traffic arteries and two bus lines passed by the store property.[1]

Since 1934, all the departments in the market, including the grocery department, had been leased to concessionaires by the Big Bear Market Company at rates varying from 3% to 10% of net sales. The departments occupying space in the store sold groceries, meats, fruits and vegetables, dairy products, candy, crackers, paint and wallpaper, shoes, yard goods, haberdashery, liquor, dresses, hats, drugs, bakery goods, real estate, and other items. Over and above the rental for the space occupied, each of the 25 departments paid a fixed percentage of its gross sales to the Big Bear Market Company to be used for advertising. The amount to be paid was determined at the time the lease was drawn up, and was based largely on the character of the merchandise to be sold. The grocery department, for instance, which did by far the largest amount of business and was the chief drawing card of the market, paid only ½ of 1% of its gross sales for adver-

[1] A commercial market analysis of the Boston territory indicated that there were 392,000 families residing within a 10-mile radius of the Big Bear Market.

tising, while the liquor department paid 3%. The average amount paid for advertising was slightly less than 2% of net sales.

The money received from the various departments for advertising was spent as the president thought best. Mr. Hanson had had long experience in the supermarket's advertising. In fact, when the company had opened the first supermarket in the area and the newspapers, under pressure from competitors of the market, had refused to carry its advertisements, he had resorted to the use of handbills. The chief means of advertising the market was still handbills, which were distributed each week by a crew of boys. Mr. Hanson estimated that about 70% of the number of handbills which the company paid to have distributed actually reached the customers for whom they were intended. This estimate was arrived at by calling 20 people each week on the day when the bills were distributed and asking whether they had received them. Another check was a statement on the handbill that, if the customer did not receive it during any particular week, he should notify the company and a duplicate would be sent out to him. The quantity of handbills delivered varied with the season. During the winter, when driving was bad, as few as 30,000 were distributed during some weeks, since Mr. Hanson believed that it would not be worth while to cover more than a limited area. During the summer, when people drove to the market in the evening from quite a distance, as many as 80,000 handbills were distributed each week. The handbills were folded sheets, issued in two sizes; the cost (including delivery) was $16.50 per thousand for the smaller size and $19.50 for the larger size. The first page of one of these handbills is reproduced in Exhibit 1.

Although the advertising receipts were spent almost entirely for handbills, the company had occasionally used other forms of promotion. An arrangement had been made with a photographer to take pictures of children entering the store accompanying their mothers. One picture was drawn from all those taken each day, and the lucky child's mother received $5 in merchandise. The photographer in the meantime attempted to sell the pictures to the mothers. This plan was abandoned after it was discovered that about 45 to 50 mothers residing within a few blocks of the market brought their children in every day and that very little really new business was stimulated.

EXHIBIT 1

BIG BEAR MARKET COMPANY

First Page of Typical Handbill

BIG BEAR

BIG BEAR WILL FILL YOUR HARDWARE NEEDS

In addition to Big Bear's stupendous food departments you will here find the best quality Hardware and Paints at the very lowest prices. So visit this section of the Big Bear whenever you need Kitchen Utensils, Wallpaper, Floor Covering or a thousand other items that make your household duties easier. Here, as in other Big Bear Departments, you are always sure to get a heaping measure of value.

SPECIALS FOR WEEK OF JANUARY 9 TO 15, INCLUSIVE, 1941

TOMATO SOUP		CAN	3¢
SHREDDED COCOANUT		LB.	15¢
EGG NOODLES	BIG BEAR	1 LB. CELLOPHANE	10¢
A & H SALERATUS		2 1-LB. PKGS.	11¢
DEL MONTE CORN	CREAM STYLE	3 CANS	25¢
PURE PRESERVES	BIG BEAR	2 LB. JAR	27¢
FRUIT COCKTAIL	BIG BEAR	LARGE CAN	17¢
BAKING CHOCOLATE		2 ½ LB. CAKES	15¢
BIG BEAR COFFEE	FRESH ROASTED	2 LBS.	29¢
CORNED BEEF		CAN	15¢

Specials for Thursday, Friday and Saturday, January 9, 10 and 11, 1941

BONELESS POT ROAST	LEAN BEEF	LB.	19¢
COOKED HAMS	READY TO EAT WHOLE OR SHANK HALF	LB.	27¢
FRESH PORK TO ROAST	RIB CUTS	LB.	15¢
SPRING LAMB FORES		LB.	12½¢
FRESH FOWL	PLUMP & MEATY	LB.	21¢
BEEF TONGUES	MILDLY CURED	LB.	19¢

PURE **Cream Cheese**	LB.	27¢
FINEST **Peanut Butter**	LB.	15¢
BORDEN'S ROQUEFORT CREAM **Cheese Spread**	JAR	18¢

NEW SAUERKRAUT	LB.	5¢
SKINLESS FRANKFORTS	LB.	15¢
LARGE BOLOGNA	2 LBS.	29¢
Machine Sliced **QUALITY PRESSED HAM**	LB.	21¢
PHILADELPHIA SCRAPPLE	LB.	17¢

We Reserve the Right to Limit Quantity

Store Hours: Mon., Tues., Wed., Thurs., 10 A.M. to 9 P.M.—Fri. 10 A.M. to 10 P.M.—Sat. 9 A.M. to 10 P.M.

In June, 1939, the company had inaugurated a radio program over one of the leading local stations (WEEI) from 8:30 to 8:45 every morning from Monday through Saturday with Eddie Lee's Bumble Bees. The announcer told about the merchandise values available at the Big Bear for that day and emphasized the convenience of shopping at the market. Five phonograph records were then played, but the titles of the selections were not revealed. The announcer asked the listeners to send in postal cards giving the names of the selections played, and the senders of the first five cards to be received with correct answers were each given a $2 merchandise credit. During the week following the receipt

EXHIBIT 2
BIG BEAR MARKET COMPANY
Registration Place of Cars in Parking Lot,
February 12–17, 1940

Name of Town	Number of Cars
Arlington	237
Billerica	18
Boston	42
Brookline	17
Cambridge	43
Dorchester	29
Everett	20
Lexington	42
Malden	52
Medford	659
Melrose	26
Newton	16
Reading	29
Somerville	212
Stoneham	38
Wakefield	13
Watertown	14
Waltham	13
Wilmington	17
Winchester	88
Total	1,625

of the cards, certain names were selected at random while the radio program was on the air, and someone from the office of the Big Bear company telephoned these people and asked the woman who answered to name the piece being played on Eddie Lee's Bumble Bee program at that time. If the woman was listening to the program and could recognize the tune, the company sent her $2. If not, someone else was called. In spite of the fact that the company received from 50 to 145 cards a day, Mr. Hanson did not consider the program worth while. The total cost, including the prizes of $12 a day, was $4,300 for the 13 weeks.

Mr. Hanson's chief reason for doubting the effectiveness of the radio program was his belief that the advertising was diffused over too wide an area. This belief was borne out by the fact that postal cards had been received from as far as 30 miles away. He pointed out that, in contrast to the widespread radio audience, a check of the license plates on the cars in the parking lot had indicated that more than 70% of the customers came from within 2½ miles of the store—Medford, Somerville, Arlington, and Winchester (see Exhibit 2). This fact corresponded fairly well to the results of a survey made in September, 1938, by a market research firm for several supermarkets, which indicated that 57% of the customers of supermarkets traveled two miles or less (see Exhibit 3).

EXHIBIT 3

DISTANCE TRAVELED BY CUSTOMERS TO SUPERMARKETS

Distance	Percentage of Customers
¼ mile	8.0%
¼–1	10.7
1–2	38.9
3–5	31.7
6 and over	10.7

Source: "What Housewives Think about Supermarkets," published by *True Story Magazine*, September, 1938.

The radio advertising which the salesman suggested that the supermarket undertake in April, 1940, consisted of three spot announcements limited to 120 words each on a program of recorded music called the "920 Club," which was broadcast from 7:30 a.m. to 9 a.m., 10 a.m. to noon, and 1 p.m. to 5 p.m. The cost would be $72 for six days a week; and if the store wished to increase the number of announcements to six a day, the cost would be $130 a week. Such advertisers as Goldman's Market, Golden's Flaked Butter Gems, Summerfield's Furniture Store, Six Little Tailors (clothing store), and Grove's Bromo-Quinine Tablets used this program. The representative of the radio station pointed out that, because the station (WORL) was a purely local one with correspondingly low rates, the return per dollar expended was higher to a local advertiser than it would be from one of the large network stations. He stated that, although studies of the value of advertising had been made by most of the stations in the area, he did not believe that the findings were of much value, because the technique of examination was so uncertain. The only proof of the effectiveness of a station, he argued, was the results which it had achieved for similar businesses. He showed Mr. Hanson a

letter from a client of the station, a large wholesale grocer who sold a private-brand line of groceries to food stores in Metropolitan Boston; the client was completely satisfied with the results which he had obtained (see Exhibit 4). The representative called Mr. Hanson's attention to the fact that the 500,000 people within 2½ miles of the market probably owned an average of 0.92 radios per family.[1]

EXHIBIT 4

TEXT OF A LETTER RECEIVED BY RADIO STATION WORL

Boston, Mass.
March 21st, 1940

Station W O R L
Boston
Massachusetts

GENTLEMEN:

I am pleased to advise you that the results obtained through advertising on the 920 Club on your station have greatly exceeded anything that we have done in radio.

At the time you approached us we were cool towards radio and specially W O R L, but your ideas seemed feasible and after the past thirteen weeks' test may I say that W O R L has proved the best medium of advertising in this section for us.

In one week period you obtained for us in exchange for a small premium over 8600 labels from Matchless Brand Food Products. This greatly exceeded all our expectations.

We expect to be with you for some time to come.

My thanks for your splendid cooperation and best wishes for the future of W O R L and the 920 Club.

Sincerely,
WEBSTER THOMAS COMPANY
By: E. M. Neilson, President

If an estimate of five people to a family were used, there was a possibility that the store's message would reach 92,000 homes in its own trade area as well as many borderline people and commuters who might find the market a convenient place at which to stop in driving to and from work.

Mr. Hanson realized that this program would be much less expensive than the previous one had been, but at the same time he believed that it had a number of disadvantages. He pointed out the fact that, because the company's part of the program consisted

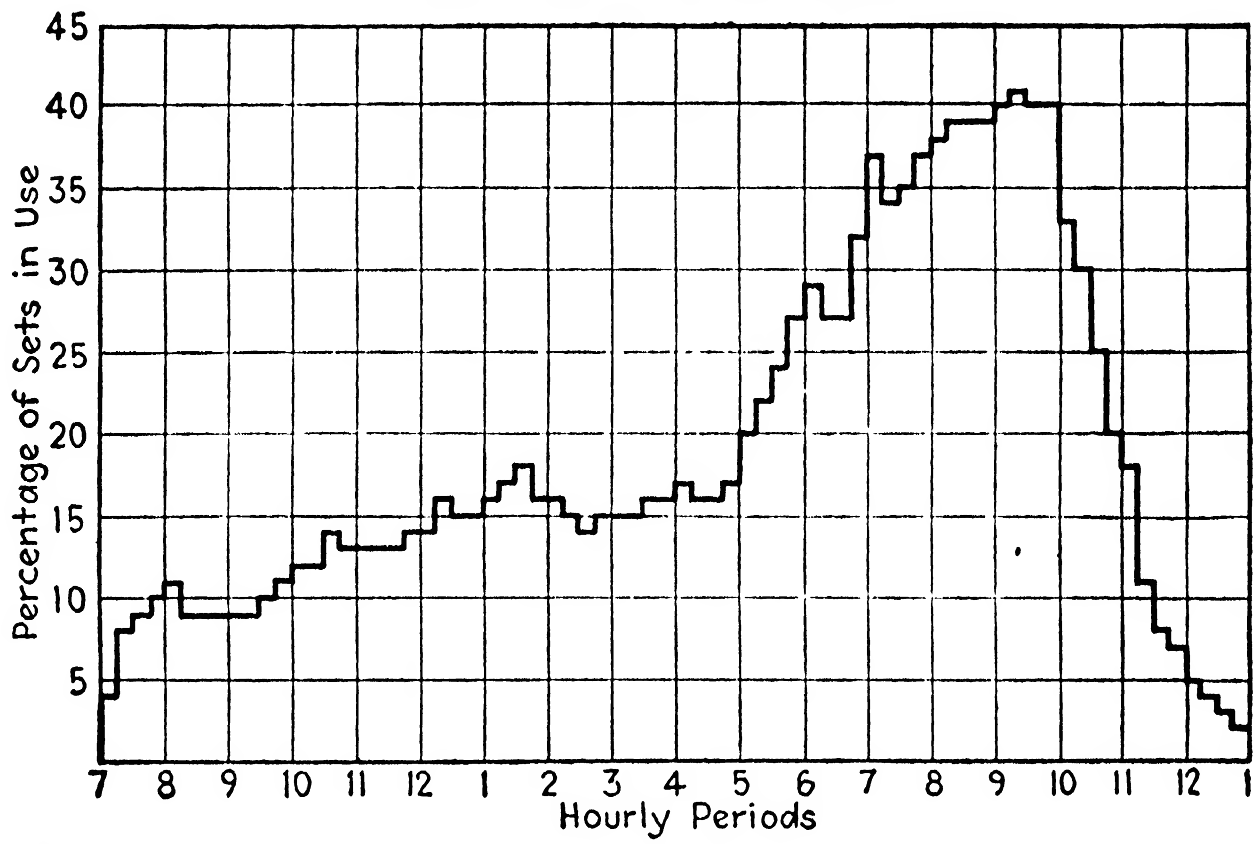
[1] Data compiled and published in January, 1940, by *Radio Advertising*, the trade journal of the radio advertising industry, indicated that this was the Massachusetts urban average.

merely of making announcements, there would be no opportunity to change the listening habits (see Exhibit 5) of the radio audience, as there had been on the former program. Moreover, he believed that the number of potential customers who listened to the 920 Club was definitely limited by the fact that there were eight radio stations in the area. The results of a survey conducted for one of the large Boston stations indicated that, of the 8,779 families

EXHIBIT 5

PERCENTAGE OF RADIO SETS IN OPERATION, MONDAY THROUGH FRIDAY, BOSTON, MASSACHUSETTS

(Based on 77,992 quarter-hours of listening, November 3, 1935, through January 11, 1936. 100% = all sets owned.)



Source: An unpublished survey conducted under the direction of Professor Robert F. Elder of Massachusetts Institute of Technology, November 3, 1935, through January 11, 1936.

visited, a great majority regularly listened to the network stations: WNAC, Yankee Network; WAAB, Colonial Network; WEEI, Columbia Broadcasting System, and WBZ, National Broadcasting Company (see Exhibit 6). Mr. Hanson's second objection was that, since the passage of the State Unfair Trade Practice Act in 1938, the supermarket's price advantage was seldom startling enough to cause people to drive any considerable distance to obtain a particular bargain. There were reported to be 140 supermarkets within 10 miles of the Big Bear Market and 6 within a radius of 2 miles. Most of these supermarkets and a great many of the chain

stores met one another's prices on highly advertised items. The fact that such a large number of supermarkets had grown up made it difficult to suggest specific advantages to be gained by trading at the Big Bear Market in contrast to others in the area. On the other hand, Mr. Hanson realized that, if the radio program did draw

EXHIBIT 6

BOSTON STATION POPULARITY PERCENTAGES, BROKEN DOWN BY HOUR PERIODS, SUNDAY, JULY 31, 1938, THROUGH SATURDAY, AUGUST 6, 1938

(Total sets in operation at each hour = 100%)

	WNAC	WAAB	WEEI	WBZ	WHDH	WMEX	WCOP	WORL	Out-of-town and Short-wave Stations
Morning									
7– 8	34.7 %	3.5 %	30.7 %	20.1 %	5.9 %	*	2.4 %	2.7 %	
8– 9	37.6	10.7	14.7	18.5	8.3	5.7 %	2.4	2.1	
9–10	16.2	14.9	24.2	31.7	6.5	1.7	3.5	1.3	
10–11	35.3	6.6	31.5	11.0	6.2	4.3	3.0	2.0	0.1 %
11–12	29.3	8.0	26.2	20.8	6.1	3.0	3.2	3.0	0.4
Afternoon									
12– 1	45.4	6.5	14.4	19.0	3.6	4.2	4.5	2.4	
1– 2	34.6	7.0	33.2	15.6	2.9	1.7	3.7	1.3	
2– 3	16.8	37.5	6.8	22.9	2.5	2.0	9.9	1.5	0.1
3– 4	27.2	57.6†	4.7	5.8	1.0	1.9	1.2	0.6	
4– 5	15.8	61.9†	3.0	11.5	1.7	4.2	0.9	1.0	
5– 6	26.8	36.4	15.2	8.1	2.6	5.5	3.4	2.0	
Evening									
6– 7	40.1	23.3	8.2	19.0	2.6	2.9	2.1	1.7	0.1
7– 8	47.6	13.3	15.2	15.1	2.4	3.1	2.0	1.1	0.2
8– 9	71.2	4.2	15.3	5.1	1.8	1.9	*	*	0.5
9–10	26.1	5.5	47.0	18.9	1.5	0.9	*	*	0.1
10–11	46.6	7.8	30.6	10.2	*	4.2	*	*	0.6
11–12	42.5	9.0	19.4	24.5	*	4.1	*	*	0.5
All-day Average	33.9	21.2	20.1	15.1	3.1	3.0	2.3	1.2	0.1

* Station not on air.

† The large WAAB audience between 3 and 5 is accounted for by the play-by-play broadcast of the National League baseball games four afternoons during week of survey.

Source: Survey conducted by the Hooper Holmes Bureau, Inc., for Station WNAC.

the attention of new customers outside the range of the company's handbills, these people would probably be large buyers, since a housewife with a small family would not gain anything by traveling far out of her way to make her purchases.

If Mr. Hanson decided to accept the sales manager's proposal to undertake the new program, he would have to obtain the consent of a majority of the concessionaires before proceeding to make further arrangements. With their approval, he would then make

up a schedule of assessments probably ranging from \$2 to \$5 a week for each of the departments concerned. Those departments, such as the real estate department, which could expect to gain little from the program, would be exempt from this charge.

How should the owner of the grocery department have voted on the proposal for the new radio program?

6. BOSTON WOVEN HOSE & RUBBER COMPANY

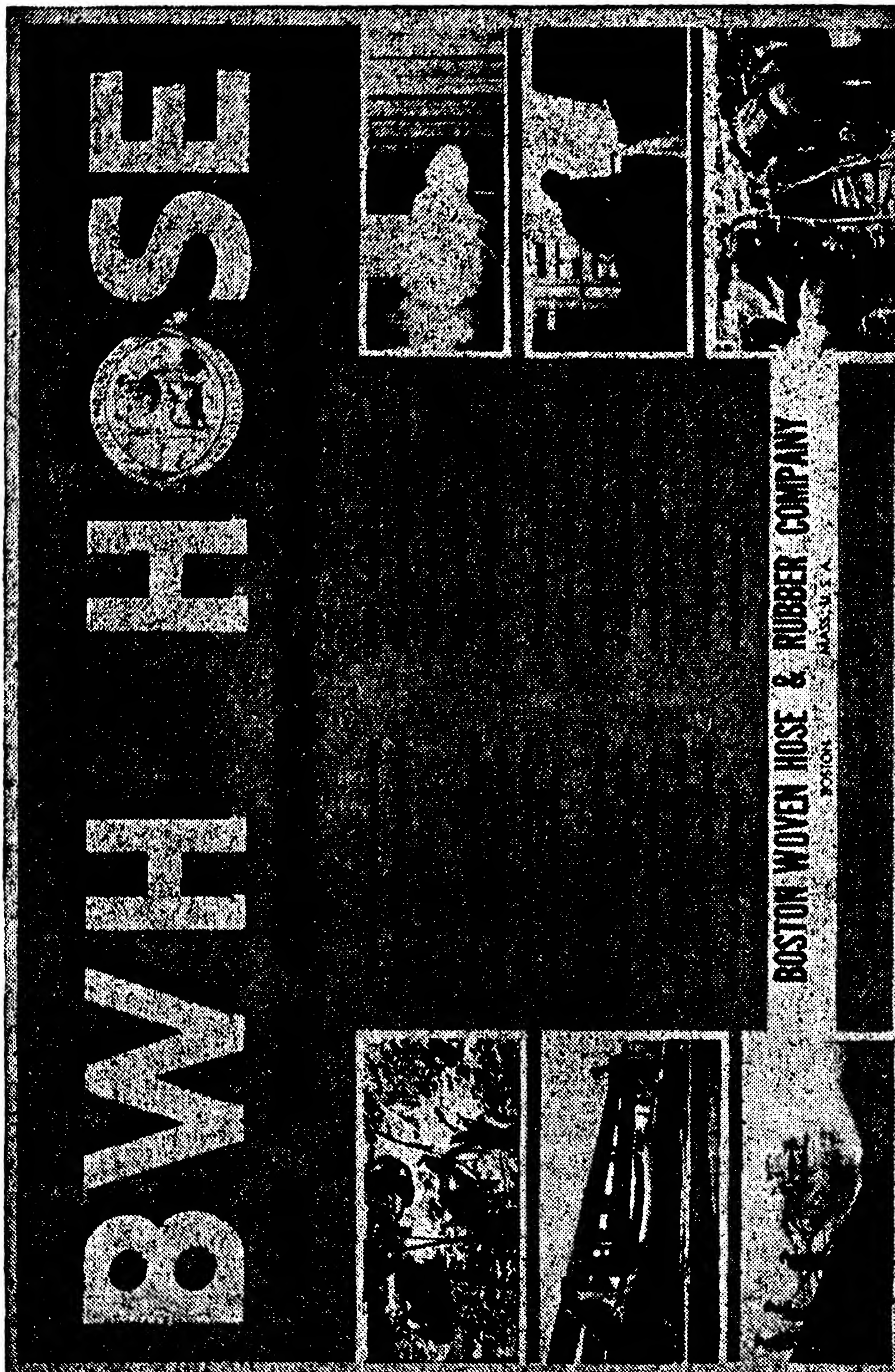
USE OF ADVERTISING FOR INDUSTRIAL GOODS

Early in 1935 the sales promotion manager of the Boston Woven Hose & Rubber Company, a manufacturer of heavy mechanical rubber goods, presented to the general manager for approval the annual budget for sales promotion. The budget, amounting to \$100,000, contained appropriations for space advertising in trade magazines, for placing the company's catalogue in Sweet's Catalog File, and for direct-mail literature.

The heavy mechanical goods of the company included rubber belting, rubber hose, and brass fittings. In the line of rubber hose were products suitable for air, water, steam, suction, creamery, brewery, dredging, sand-suction, solvent, spray, welding, gasoline, fire, and mill hose. The rubber-belting line comprised transmission belts, heavy-duty and high-speed conveyor belts, and belts for canning factories, grain elevators, oil fields, and bucket elevators and for specialized uses in agriculture. The products of the company were marked with individualized brand names, which also indicated quality. On the highest grades of all products a common brand name was used.

Nearly all sales of the company were made to mill supply firms which had exclusive agencies. The company maintained a salesforce of 50 technically trained men, who sought orders from these agencies and who assisted these firms in making sales to their customers. Since these salesmen were engaged in missionary selling for mill supply accounts, they were paid straight salaries. The company did not expect the normal cost for traveling expense and salaries of the salesforce to exceed 5% of sales, although during the depression after 1929 this ratio had risen to 7½% of sales.

Exhibit 1
Boston Woven Hose & Rubber Company
Sample Advertisement



The executives believed that the space advertising and the catalogues of the company also gave the exclusive agents great assistance in selling.

For 1935 the sales promotion manager proposed that the company continue its advertising in trade papers. He recommended that space be used in such journals as *Factory Management and Maintenance*, *Industrial Power*, *Mill and Factory*, and *Chemical and Metallurgical Engineering*. These magazines reached executives in a wide variety of industries. In addition, he suggested that the company continue to advertise in such media as *Coal Age*, *Engineering and Mining Journal*, *Pit and Quarry*, *Rock Products*, *Paper Industry*, *Engineering News-Record*, *Electrical World*, *Electrical Contracting*, *Electrical Wholesaling*, *Mill Supplies*, and *Steel*. These journals reached specialized markets or customers in specific industries.

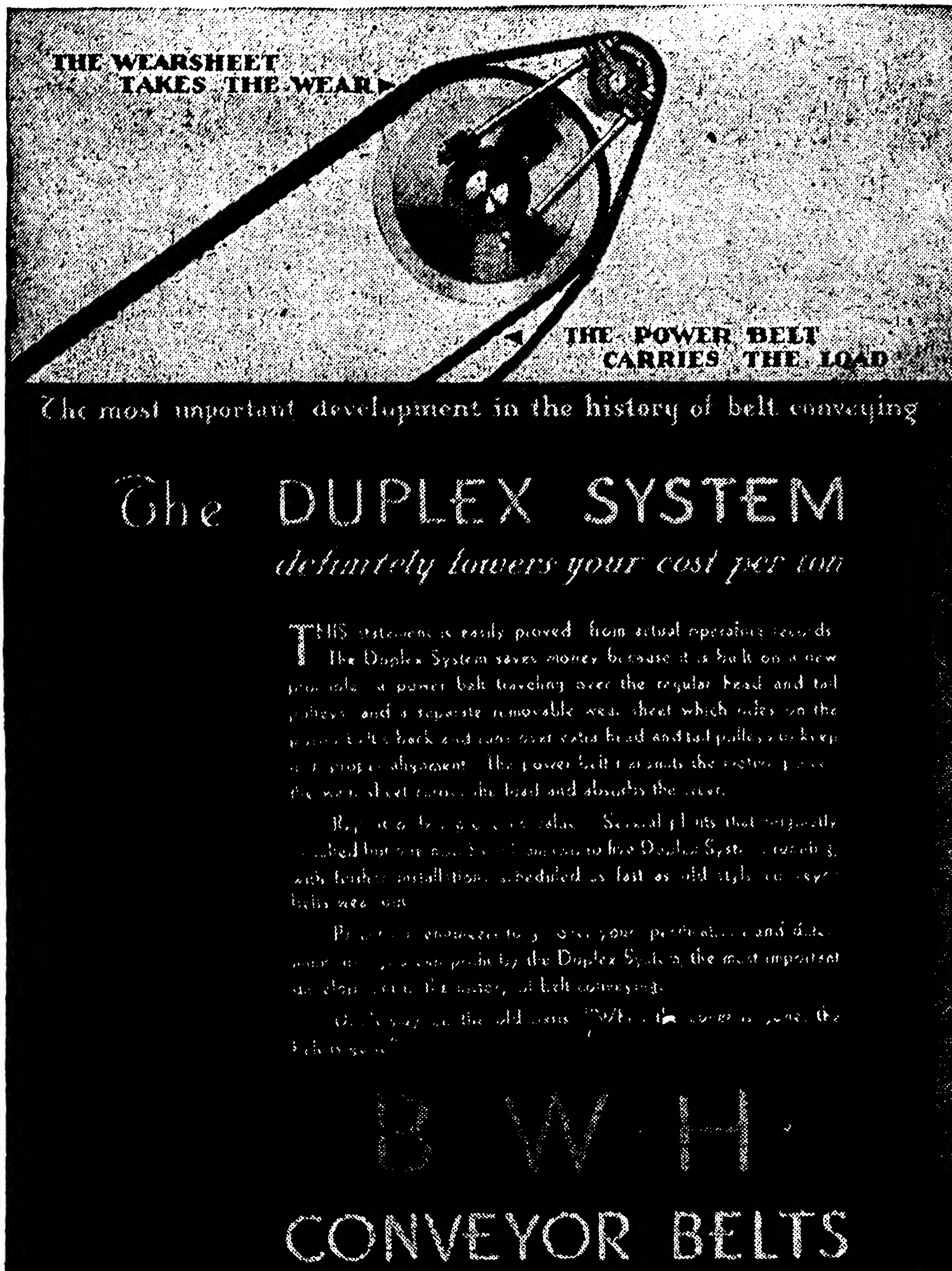
The copy used in trade journals usually was of a news-value type. The sales promotion manager intended that this copy should enhance the institutional reputation of the company and, if possible, lead users to specify the brand names of the company. For instance, in one double-page spread (see Exhibit 1) appearing in the *Engineering News-Record*, six illustrations of different applications of the rubber-hose products of the company were shown.

In a four-page advertisement appearing in most of the trade journals mentioned above, the company announced the perfection of a new process of manufacture which would increase the uniformity of transmission belting and lead to greater efficiency and economy in its use by the customer. Another advertisement, describing the duplex system of conveyor belts, was as shown in Exhibit 2. A third two-page spread had very little text but included excellent illustrations of the product in use on two public works construction jobs of interest to engineers and contractors who were readers of the *Engineering News-Record*. The text of this advertisement follows:

Boston Woven Hose Conveyor Belts are moving millions of cubic yards of material at Fort Peck. Again as at Grand Coulée these outstanding belts are demonstrating the acknowledged B.W.H. reputation for extra-quality mechanical rubber goods.

This gigantic construction job on which we had the privilege of cooperating with the Jeffrey Manufacturing Company is further evidence of the intrinsic quality of B.W.H. Conveyor Belts on work of the most important character.

EXHIBIT 2
BOSTON WOVEN HOSE & RUBBER COMPANY
Sample Advertisement



Several proposed advertisements of the company devoted space to the description of the company's brand names for belts. The copy from one of these advertisements was as follows:

BULL DOG

The belt for "Supreme Duty." This means the severest possible service under the most difficult conditions. Bull Dog conveyor belts carry the extremes of weight and abrasion that ores, crushed rock and other mine and quarry materials can inflict. Bull Dog is the belt to specify whenever you have a most difficult and exacting conveying problem.

These are the construction details. Weight of duck—28, 32, and 36 oz. Tensile strength of covers—3500 to 4000 lbs. Friction between plies—20 to 24 lbs. Breaker strip when specified.

SILVER KING

If your conveying job consists of crushed stone, broken glass, sharp sand, cement rock, lump coal, char, wet sugar, and similar materials, we recommend Silver King.

This belt is built for "Superior Duty." It is designed for all heavy-duty work which does not require the supreme quality of Bull Dog.

The weight of duck used is 28, 32, and 36 oz. Tensile strength of covers—2500 to 3000 lbs. Friction between plies—16 to 19 lbs. Breaker strip when specified.

AUROCHS

We call Aurochs our "Hard Duty" belt because it is designed for general all-round hard duty such as coarse gravel, sand, hard coal, and the ordinary run of stone and rock. Specify Aurochs wherever conditions call for a high-quality belt, better than average in general quality, but where the expense of Silver King or Bull Dog is not justified by the actual service involved.

It is constructed of 28, 32, and 36 oz. duck. Tensile strength of covers—1400 to 2000 lbs. Friction between plies—12 to 15 lbs. Breaker strip when specified.

IRON CLAD

This is the popular "Average Duty" belt. Iron Clad is built with the same careful construction and superior materials found in all B.W.H. belts, with the details of construction scaled down to be thoroughly competitive in price—a belt that is economical to install, efficient in service. We recommend Iron Clad for handling small-sized stone, ordinary sand and gravel, soft coal, cement, lime, chips, pulp, fine crushed stone, and for general conveying service.

Weight of duck—28 and 32 oz. Tensile strength of covers—800 to 1000 lbs. Friction between plies—12 to 15 lbs.

The proposed promotional budget for 1935 contained an item of $4,000, which covered the cost of placing the company's catalogue

in Sweet's Catalog File,[1] and it included $6,000 for direct-mail literature to follow on the placement of the catalogue. Though these sums were relatively small in contrast to the size of space appropriations in trade journals, nevertheless the sales promotion manager considered the use of catalogues one of the most effective means of sales promotion employed by the company. Ordinarily the company issued a catalogue once every five years at a cost at the time of issue of about $10,000.

In the year 1934 the company decided to file its catalogue in Sweet's Catalog File, at a cost of $4,000 for the year's service. The sales promotion manager and the executives of the company were induced to take this step for three reasons. In the first place,

[1] Sweet's Catalog File was the name for eight bound volumes (8½ inches by 11 inches) of catalogues, published annually by Sweet's Catalog Service, a division of the F. W. Dodge Corporation. The titles of the volumes were: (1) Process Industries; (2) Mechanical Industries; (3) Power Plants; (4) Engineering; (5) Architectural (four volumes). Sweet's Catalog Service sold space in these volumes to manufacturers in much the same manner as magazines sold space for advertising. The published rates for catalogue space in each of these volumes varied partly according to circulation and also according to the amount of catalogue space taken by a manufacturer. The minimum space that a company could buy was one page, and there was no maximum limit. Any amount of space in one or all of the volumes could be used by a manufacturer. If a company purchased as many pages as 12 in one volume it could place a cover on its catalogue and could have a choice of layout and type; if it bought less than 12 pages, the layout and type were determined by the standard rules of Sweet's Catalog Service. Each Catalog File was carefully indexed according to company name and product. The placement of a company catalogue in Sweet's Catalog File was called "prefiling" by Sweet's Catalog Service.

One of the functions of Sweet's Catalog Service was the preparation of catalogues for manufacturers selling to one or more specialized markets. The service maintained a staff of consultants, consisting of architects, engineers, and technical writers, who consulted with clients in the preparation of a catalogue. A staff of copy writers and layout experts was also retained. Sweet's Catalog Service also made the arrangements for printing catalogues.

Another function of Sweet's Catalog Service was the distribution of these bound catalogues to the various markets according to their requirements. It was the intention of the Service, for instance, to place a free copy of the volume on process industries with every manufacturing establishment in the United States employing 100 men or more or having a connected power load of 500 hp. or more. The volume on power plants was filed with 6,000 generating plants and any industrial plant with a generating capacity of 500 hp. or more. Sweet's Catalog Service estimated that its catalogues were in the hands of firms employing 69% of the man power and 71% of the horsepower used in the United States. Its volume for the architectural field was filed with over 13,000 different firms of contractors or engineers, architects, or designers.

Companies whose catalogues were in Sweet's Catalog File were given the names of firms which had received a copy of one or more volumes of the Sweet's Catalog File and in addition were given the names of the persons within these organizations who actually controlled buying and specifications. Usually these persons were the ones who gave specifications to purchasing agents. This list the Sweet's Catalog Service kept currently up to date at considerable expense.

Sweet's Catalog Service had an organization of expert catalogue builders, whose competence, in the opinion of the sales promotion manager of the Boston Woven Hose & Rubber Company, was unquestioned. As a result of its specialization in the preparation of catalogues Sweet's Catalog Service could obtain the proper information from the executives of the company and could use the facts to design a catalogue equal or superior to those previously produced by the company itself. The burden on executives in the preparation of this catalogue was thus considerably reduced, and the company was able to buy from Sweet's Catalog Service 15,000 catalogues for distribution to mill supply firms and users at a saving of 25% over comparable bids of job printers.

The second reason for employing Sweet's Catalog Service was that the file was placed in the offices of at least 20,000 of the industrial plants in America. The sales promotion manager considered the names of the firms receiving Sweet's Catalog File to be one of the most valuable lists which he could obtain. The sales promotion manager allocated the names on this list to the exclusive mill supply firms representing the company; thus, the mill supply firms obtained the names of prospective customers and knew exactly which com-

EXHIBIT 3

BOSTON WOVEN HOSE & RUBBER COMPANY

Letter to Industrial Users

GENTLEMEN:

You will see the enclosed four-page advertisement in many of the leading trade journals during December and January.

On the two inside pages you will find a list of our entire line of manufacture, but we especially call your attention to the fourth page of this advertisement.

We take considerable pride in the fact that we are devoting a great deal of energy and money in the perfection of better products for industrial service, and our recently announced process for continuous vulcanization of transmission belting with which you are already familiar is distinct evidence of this fact.

As stated in this advertisement, other new and important improvements are now being developed. Mechanical rubber goods can be judged only on a basis of service rendered. While B.W.H. products are invariably competitive in price, they contain that extra measure of service which affords the buyer a premium for specifying B.W.H. brands, thus reducing the ultimate cost of the product regardless of the size of the initial investment.

B.W.H. mechanical rubber goods are distributed in your territory by—

....

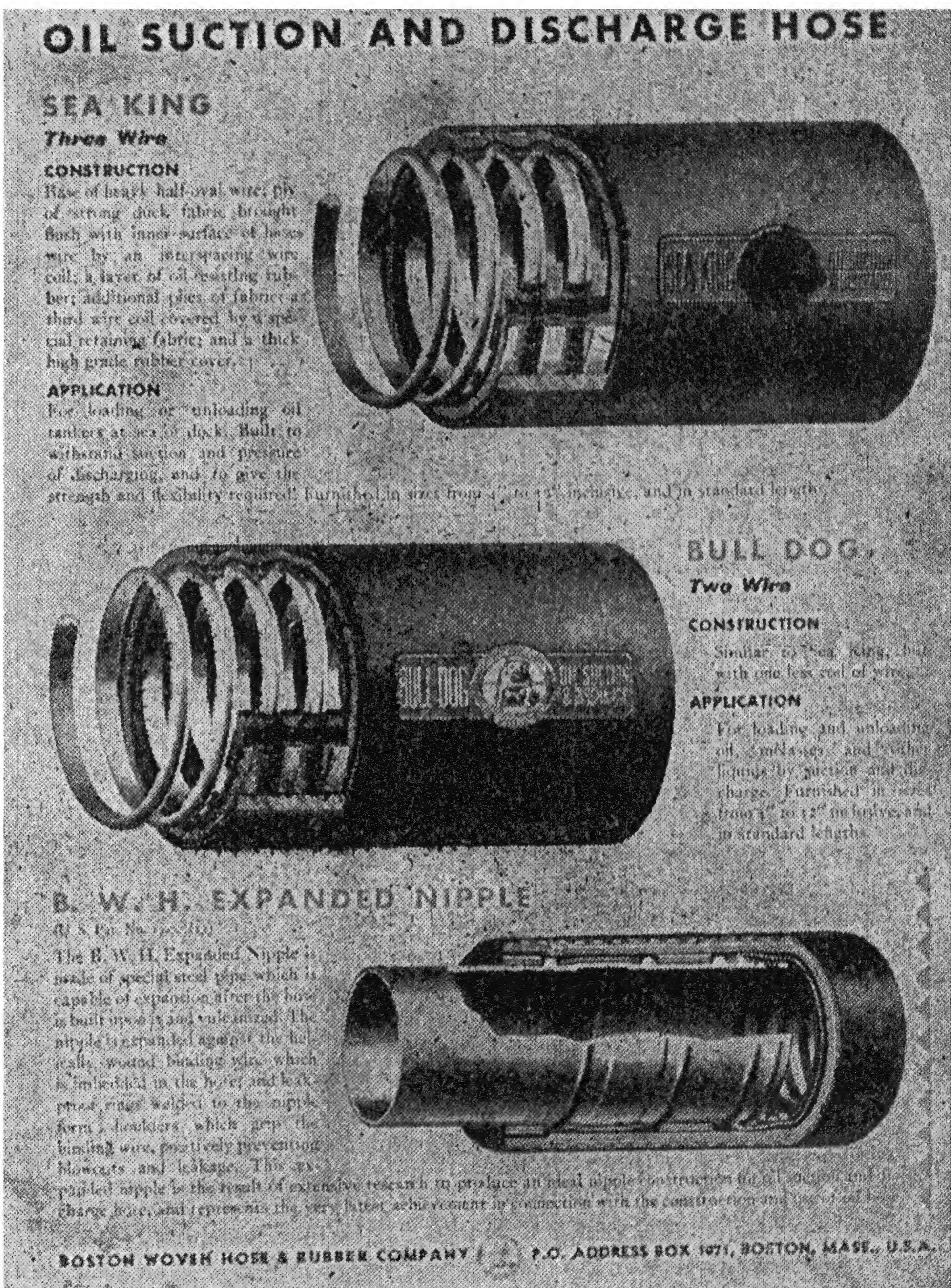
....

who carry a stock of all popular grades and sizes and will be pleased to have the opportunity of suggesting the B.W.H. brand best suited for your service.

Whenever you are in the market for transmission, conveyor, or elevator belting, hose for any industrial use, sheet packing, friction tape, or any of the items listed in this advertisement, it will pay you to get in touch with our distributor and secure genuine B.W.H. mechanical rubber goods for economy and efficiency.

Or shall we send you a loose, separate copy? In either case it will be the same catalogue.

EXHIBIT 5
BOSTON WOVEN HOSE & RUBBER COMPANY
Page from Catalogue



The customer noted his opinion at the bottom of the letter and returned it to the company. Answers to this letter came from 2,320 customers; 1,452 indicated a definite preference for Sweet's

Catalog File; 705 preferred the individually bound catalogue; and 163 were neutral. In view of these preferences of customers the sales promotion manager thought that the company should continue to file its catalogue in Sweet's for the year 1935.

The full catalogue of the Boston Woven Hose & Rubber Company contained 48 pages of text and index, but only 24 of these pages were filed in the Sweet's Catalog volumes for Process Industries and Mechanical Industries. Twelve pages were filed in the volumes for Power Plant Industries and Engineering Industries. A page from the catalogue is reproduced in Exhibit 5. The catalogue was not filed in the architectural volumes.

Copies of the company's catalogue were mailed direct to industrial users who preferred to receive it in this way. Copies also were placed in the hands of industrial supply firms for redistribution, and the missionary salesmen used the catalogue in connection with their calls on the customers of supply firms.

The sales promotion manager of the company thought that the proposed plan of space advertising, catalogue distribution, and direct-mail follow-up of both these media gave the salesmen of the company and of the supply firms ample assistance in their efforts to sell B.W.H. products to industry. He also believed that the company's 48-page catalogue and 24-page insert in Sweet's Catalog File were of real use to industrial buyers. These buyers wanted full information about a company and its products. The catalog provided a permanent source of data for buyers; it often was used by engineers or purchasing agents before a salesman called; and it also represented the company between visits of salesmen.

In contrast to the view frequently expressed, that the main function of advertising for a manufacturer of industrial goods is to keep the manufacturer's name before the market, did the program of the Boston Woven Hose & Rubber Company represent a profitable expenditure of promotional funds?

7. GRANDJEAN COMPANY

ADVERTISING POLICY IN WARTIME

In drawing plans for the 1942 advertising of its wires and cables, the Grandjean Company of New York was faced with important questions regarding the size and character of the advertising program for the year. As a result of war developments, the company's plant was producing far in excess of what was deemed its normal capacity and had on file hundreds of orders that probably could not be filled because, before they could be put into production, they would be superseded by other orders with higher priority ratings. Clearly, advertising was not needed to develop sales, for the company was oversold. On the other hand, the high level of income of the company would permit heavier-than-usual advertising. Thus the executives needed to determine what advertising policy the company should adopt.

The Grandjean Company was engaged in the manufacture of wires and cables insulated with rubber, varnished cambric, impregnated paper, and plastic insulation. Throughout its 60 years the company had been a leader in the technical development of insulated wires and cables, particularly of rubber and insulated cables, and was in 1942 one of the largest producers in the country. Under normal conditions its sales were in excess of $3,000,000 a year; under the lend-lease program and later, with the country at war, sales had mounted considerably beyond this figure. The Grandjean Company operated in a field in which there were some eight or ten strong, well-established competitors and a number of less important producers.

The company promoted several specialized types of insulated wires and cables under special brand names, as well as a large variety of wires and cables under the company's name alone. Thus the Grandjean name had become associated not only with wire and cable in general but with brands of individualized cables which were widely known throughout industry.

Among the important lines of the company were the following:

1. Grandjean *Rubwear* cords and cables represented a development pioneered in the company's laboratories in the early 1920's. *Rubwear* cords and cables consisted of one or more strands of insulated conductors protected by a reinforced rubber sheath, which gave flexibility and unusually long wear, qualities desirable in cords and cables subject to

friction and rough usage. The construction of the insulation was similar to that of a cord tire. The rubber compound used in the sheath was resistant to moisture, gas, grease, and alkalis. *Rubwear* cords and cables would not kink and were from four to ten times as durable as the average wire covered with braided or woven insulation; they ranged in size from 4-inch cables down to small light cords and conductors. The line included large cables used on electric shovels and cranes, dredges, and mining machines; heavy cords employed on portable tools and apparatus in steel mills, factories, shipyards, and metal-working plants; and small appliance cords attached to household and office appliances and to light extensions. Competitors had quickly copied Grandjean *Rubwear* construction, and cables and cords of this type were widely used.

2. Grandjean *Anti-aqua* cables had been developed in the company laboratories during the 1930's. *Anti-aqua* cables were covered with a rubber compound which did not absorb water. Previously, rubber insulation submitted to intermittent or continuous submersion had, in the course of time, absorbed water and disintegrated. *Anti-aqua* cables were satisfactory for placement direct in the ground or in ducts or for submarine work. They were used for lighting circuits, municipal street lighting, park playground lighting, airport illuminating work, and power or communication circuits in water. For many purposes they were regarded by the company as superior to the lead-sheathed cables which had formerly been required for use in installations exposed to water.

3. Grandjean *Verithin* cables the company had developed through pioneering work in the use of liquid rubber latex for thin insulation of electrical conductors. *Verithin* cables were especially designed for police and fire alarm signal systems, telephone and telegraph transmission, and other uses requiring a large number of small rubber-insulated conductors in a cable of minimum diameter.

In addition to these three specially branded lines, the Grandjean Company sold under the company's name wires and cables suitable for hundreds of uses in industry, such as oil-proof cords, parkway and network cables, telephone and telegraph cables, building wires and cables, tree wires, pole fixture and arc cables, rubber-insulated power cables, varnished cambric cables, paper-insulated power cables, and plastic-insulated cables. Several of these products were designated by specialized brand names, but the names were not so widely publicized or so well known as Rubwear, Anti-aqua, and Verithin.

The markets for Grandjean products were many. Electrical utility and communication companies and building contractors were important buyers for electrical installations. Manufacturers

of numerous types of machines and electrical appliances bought cords and cables to include in their products. Important replacement demand existed in certain industries, for cords and cables wore out, particularly when subjected to movement and friction. Thus the mining industry, in which cables were extensively used, provided an important market, as did the construction, metal-working, and marine industries.

In addition to the home sales office in New York City, the company had branch sales offices in 9 important cities of the United States and manufacturers' representatives in 14 other less important markets. These branch offices and the manufacturers' representatives sold the company's products direct to central stations, to large manufacturers, to electrical wholesalers, and to some mill supply firms. All the branches and the offices of manufacturers' representatives were equipped to give engineering advice regarding wires and cables.

The company for many years had been a consistent advertiser of its products to industry, employing industrial papers, catalogues, direct mail, and exhibitions. The advertising objective was to make Grandjean products, particularly the three important branded lines, known throughout the principal markets. Advertising was regarded as complementary to the personal selling activities of the company's salesmen, representatives, and distributors. The company appropriated no fixed percentage of sales for advertising but rather whatever amount was necessary to carry out the schedules deemed desirable for the sales program. In normal times the advertising expenditures were in the neighborhood of 1% of sales. Of the appropriation, approximately one-half was used for direct mail; much of the remainder was used for industrial paper advertising.

In its publication advertising the company placed chief reliance on *Electrical World*, a leading magazine in the electrical field, published biweekly. In the latter part of 1941, *Electrical World* had a net paid circulation of approximately 17,000 copies, distributed primarily among electric power and light companies, consulting engineers, engineering firms, and industrial and electrical manufacturing companies. This publication was looked upon as a horizontal medium, reaching important executives and engineers throughout industry who might specify or influence the purchase of cables and wires. In 1941 the Grandjean Company took three

pages a month in the magazine, one page for each of the three important branded lines.

In addition to its use of *Electrical World*, the company had taken space in certain vertical media reaching its more important markets. Thus, it had been for many years a regular advertiser in *Coal Age*, which had a circulation of some 12,000 copies among executives and engineers of coal mining companies. Likewise it had used the *Engineering Mining Journal* to reach the metal mining field, *Marine Engineering* to reach the marine field, and the *American Machinist* to reach metal working companies. The Grandjean Company had not used such a magazine as the *Engineering News-Record* to reach contractors and construction companies; but executives had discussed the desirability of adding this medium, for the market reached was worthy of more intensive cultivation than had been given to it.

Over the years, the company had come to place great reliance on direct-mail advertising, spending about half its appropriation on this medium. It had built up excellent mailing lists of customers and of prospects for its various wires and cables and had exercised much care in maintaining these lists. Since the names were grouped according to interest in individual Grandjean products, the company could readily direct messages to selected lists of users and prospects for any of its chief lines.

In addition to its advertising in industrial journals and by direct mail, the company issued catalogues giving the descriptions and specifications of the products in its several lines. The catalogue dealing with Grandjean Rubwear portable cords and cables, for instance, comprised some 70 pages and included directions for splicing and repairing cables. To supplement the catalogues for individual lines, the company published a manual for electrical engineers, contractors, and wiremen, which was an authoritative, scientific treatise on cords and cables in general and Grandjean products in particular. The data in this manual were carefully compiled by company engineers, and a revised edition was published every five years. The manual was so widely sought by engineers and others for their working libraries that the supply of 20,000 copies ordered on the first printing of the 1940 edition was exhausted within a year and a reprint was necessary, even though the manual was not advertised.

A relatively small percentage of the Grandjean advertising appropriation was devoted to occasional showings of Grandjean products at industrial exhibitions. For instance, the company exhibited at the coal exposition held in Cincinnati.

In its industrial paper advertising and in its mail advertising the company had endeavored not merely to build a reputation for itself and its products but also to tie directly in with sales-producing efforts, when possible. It often sought inquiries regarding its catalogues and data sheets or its engineering service, hoping by this means to secure action-getting leads. Numerous copy approaches were employed in accordance with the particular needs of the moment; but much of the advertising had been of a performance type, conveying in pictures and copy the ability of Grandjean wires and cables to meet exacting requirements on specific jobs. In this way the company had sought to build around its brand names strong associations of the characteristics of particular products and their suitability for specific purposes. About the company name it had tried to build a reputation for leadership in cable research, for engineering ability, and for the general dependability of Grandjean products.

Questions as to whether the company should increase or decrease the volume of its advertising and whether and how it should change the character of its advertising began to come to the fore during 1941, when, under the lend-lease program, sales of the company's products mounted rapidly and were subjected increasingly to priority rulings of the Office of Production Management. By the summer of 1941 the shortage of copper had become acute, and shortages in other materials were threatened. Because of priorities and conservation orders the company was unable to meet the demand for its products and increasingly was receiving complaints from old customers to the effect that they were not being accorded the attention and service to which they felt they were entitled because of their past patronage.

With the entry of the United States into the war, what had been a difficult situation became acute. Rubber, tin, and jute, important raw materials, were very scarce, and copper, lead, and plastics were becoming increasingly hard to obtain. Government conservation orders on these materials greatly restricted use. Moreover, no order on the company's books could be filled unless

it had a very high priority rating. The company's plants were producing outputs far beyond what had ever been dreamed of as capacity, and still there was a great backlog of unfilled orders. Instead of needing to solicit business, the company was in the position of having an excess of orders, which it must route into production in accordance with government priority requirements. The requests of many of its long-standing customers could not be met.

Under these conditions the management laid down certain guiding policies, as follows:

1. That the entire resources of the organization should be devoted solely to help in winning the war
2. That all government restrictions and regulations designed to conserve critical materials should be strictly followed
3. That products should be changed and modified to keep within the required limits of use of critical materials as laid down by the War Production Board
4. That, wherever possible, the company's products should be redesigned to use materials which were comparatively plentiful
5. That the company's special brand names should not be stamped on products for which the specifications laid down by the government departed far from Grandjean standards
6. That certain products should be discontinued for the duration of the war if restrictions on the use of materials prevented the manufacture of a substitute worthy of Grandjean
7. That the company should intensify its research, not only to help the war effort but also to improve its products for the postwar period.

In considering the advertising course to adopt for the war period, executives made inquiries regarding the policies adopted by other manufacturers and found wide differences in opinion and practice. At one extreme were manufacturers who had discontinued all promotional effort. For instance, it was reported that the Ford Motor Company had practically ceased to advertise shortly after its facilities were converted from civilian to war production. At the other extreme were companies which had greatly increased their advertising activities; certain manufacturers of airplanes and airplane parts, for instance, were devoting a portion of their greatly augmented revenue to general consumer advertising, which they hoped would enhance their reputations as manufacturers and gain the goodwill of future air transportation executives.

Between these extremes there were varying shades of practice and opinion as to the proper advertising policy to be followed during the war. A number of publishers of industrial magazines urged that advertising be used as a supplement to the news and editorial pages to give needed information to readers. They pointed out that the cry for increased production and the scarcity of materials called for wise guidance of manufacturers in conservation and in production methods and that such guidance could probably best be supplied by specialized manufacturers of industrial machines and products. They maintained that companies providing informational service not only would contribute to the war effort but would effectively lay a foundation for future business through the assistance given to potential buyers of their products. Accordingly the publishers urged advertisers to maintain their advertising schedules, using copy designed to promote conservation and more productive use of existing equipment. Examples of such use of advertising were increasingly numerous during the latter part of 1941. A manufacturer of machine tools in his advertising gave a series of detailed, illustrated directions on how to use tools so as to get maximum production and minimum breakage. A pump manufacturer ran a series of advertisements on "how to keep pumps young." A manufacturer of valves and fittings ran specific illustrated instructions on steps to follow in order to prolong the useful life of valves and fittings. A manufacturer of bits for oil wells ran a series of suggestions for increasing the service life of his products. A glass company ran a series on a new development it had worked out, "a new technique for sash replacement panels that require no critical metals." A manufacturer of lathes and other metal working machines ran advertisements on methods of solving production problems met by users of tools such as he manufactured. In most instances, the advertisements referred to informational booklets which were available upon request.

Some advertisers turned to institutional copy of various sorts. Not infrequently advertisements told of the contribution which the particular company and its workers were making to the war emergency and pointed out that such effort kept the company from carrying on its usual business or from giving its usual service. Other advertisements emphasized the importance of the past and current research of the particular company, both for the war and for the postwar period.

In addition to considering the Grandjean Company's own needs and the policies of other manufacturers, the company executives gave thought to the bearing which the income tax law might have on the volume of advertising. The excess profits tax amendments of 1941 called for heavy increases in the taxes on excess profits.[1] Spokesmen of the Treasury Department made it clear, however, that the department would be critical of, and would disallow in the computation of taxes, unusual increases in costs which might adversely affect the profit showing of a concern. Like many other industrial concerns engaged in war production, the Grandjean Company anticipated that its earnings before taxes in 1942 would be larger than normal.

In its advertising program for 1942, should the Grandjean Company have increased or decreased its advertising appropriation?

What should have been the objectives of its advertising?

What principal types of copy should it have used?

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[1] Under these amendments a concern could adopt one of two methods in computing its figure for excess profits. Briefly these were as follows: (1) From its total profit figure it could deduct as a credit 95% of the average earnings for the years 1936–1939 inclusive, with provision for adjustment in the amount credited because of decreases or increases in the concern's invested capital subsequently to 1939. (2) From the total profit figure it could deduct as a credit 8% on the first $5,000,000 of invested capital, as defined by the statute, plus 7% on all invested capital over $5,000,000.

The tax to be levied on the excess profits computed by one of these methods varied in accordance with the amount. When the excess profits were not over $20,000 the tax was 35%. At the other extreme cited in the statute, when profits were in excess of $500,000 the tax was $255,000 plus 60% of any excess profits over $500,000.

VIII

MARKETING ORGANIZATION AND CONTROL METHODS

1. COBB COMPANY

MARKETING ORGANIZATION

The Cobb Company and the Stubbs Company were subsidiaries of the Stevens Company. The executives of the Stevens Company were disposed to think that the organization of the Stubbs Company was superior to that of the Cobb Company; accordingly they asked the sales manager of the Cobb Company to study the plan of the Stubbs Company and to consider its adaptability to the situation of the Cobb Company.

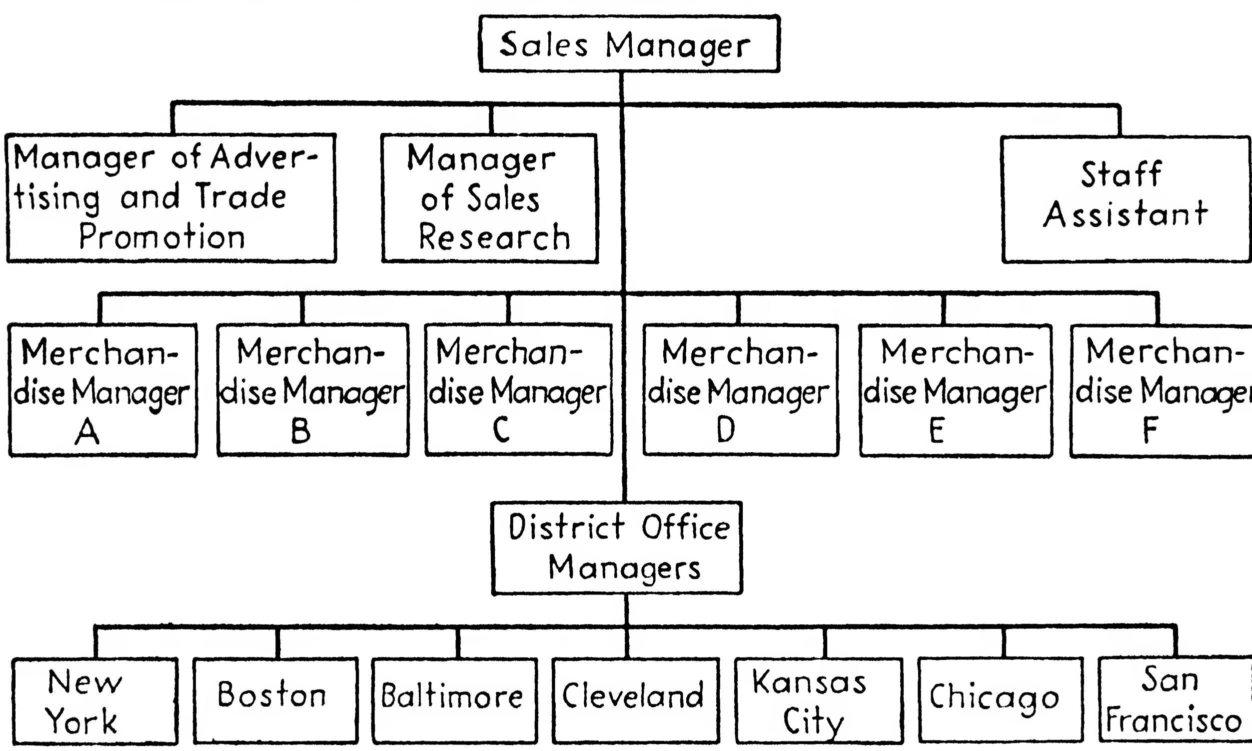
The existing marketing organization of the Cobb Company was as shown in Exhibit 1. The sales manager was the head of the marketing department. He reported in line capacity to the general manager of the Cobb Company and in staff capacity to the vice president in charge of sales for the Stevens Company. The major responsibilities of the sales manager were product planning, advertising and trade promotion, and management of salesforce. The details of product planning were worked out by six merchandise managers, each of whom reported directly to the sales manager. Advertising and trade promotion work was under one department head. The sales research department studied potential sales for each of the company's markets and analyzed sales data at the request of the sales manager. The clerical details of the administration of the marketing department were intrusted to a staff assistant.

The merchandise departments of the Cobb Company were organized on a product and market basis. For example, Department A, in charge of Merchandise Manager A, included a line of products different in the main from the products of the other merchandise departments. Departments B and C, on the other hand, had the same basic line of products but different markets. Department B, for instance, was concerned with the product as

it went to the consumer market, whereas Department C was concerned with the industrial markets. The volume of sales represented by these merchandise departments was as follows: Department A, \$3,500,000; Department B, \$1,600,000; Department C, \$1,200,000.

The task of each of the merchandise managers was to determine what products to make, what items to discontinue, what quantities and qualities to manufacture, and what type of packaging to use. It was his task also to prepare the sales program for the year, which included detailed plans for advertising and dealer cooperation. In addition he prepared a budget of sales, costs, margins, and net profits. The plans and budgets were submitted to the sales man-

Exhibit 1
Chart of Sales Organization of the Cobb Company



ager, who analyzed them for approval, correction, or rejection. The final approved budget passed from the sales manager to the general manager of the company and through him to the Stevens Company.

The selling operations of the company were carried out through the various district offices. The company employed 25 salesmen in all. The sales volume of district offices ranged from \$500,000 to \$2,000,000. The salesforce in each office was segregated, so far as practicable, by lines of product and type of outlet.

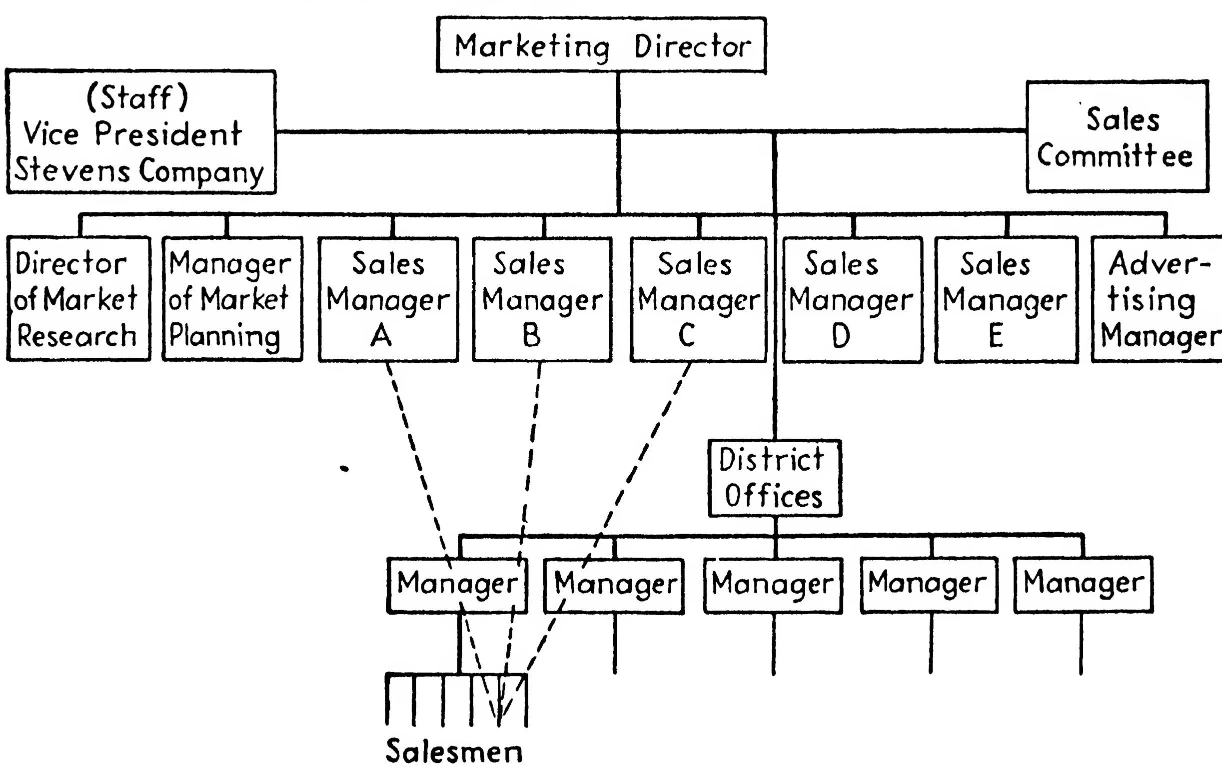
The chief criticisms of the marketing organization of the Cobb Company by the executives of the Stevens Company were that the organization resulted in an unbalanced merchandise program and

that the setup imposed too much detail upon the sales manager. For this reason they urged that the organization plan of the Stubbs Company be given careful study.

The sales organization chart of the Stubbs Company was as shown in Exhibit 2. The marketing director of the Stubbs Company was responsible in line capacity to the general manager of the Stubbs Company and in staff capacity to the vice president in charge of sales for the Stevens Company. The sales committee, which sat in advisory capacity to the marketing director, was composed of the director of market research, the manager of market planning, the advertising manager, and the sales managers of the five merchandise departments.

EXHIBIT 2

CHART OF SALES ORGANIZATION OF THE STUBBS COMPANY



The market research organization of the Stubbs Company was primarily a fact-furnishing department. It conducted tests in stores to determine the consumer acceptance of new or old products. It also gathered the facts with reference to products, markets, and channels of distribution. This department made use of the statistical data prepared for it by the accounting department, which was outside the marketing organization.

The market planning organization, on the other hand, used the facts furnished by the market research organization in developing new ideas and in carrying out other functions of the department. The market planning organization worked closely with the produc-

tion department on the development of new products and the better adaptation of old products to market requirements. In addition, the market planning department prepared quotas for salesmen, outlined sales policies and sales schedules, and worked out the coordination of advertising with personal selling and other promotional work. The advertising manager executed the technical details of this advertising program.

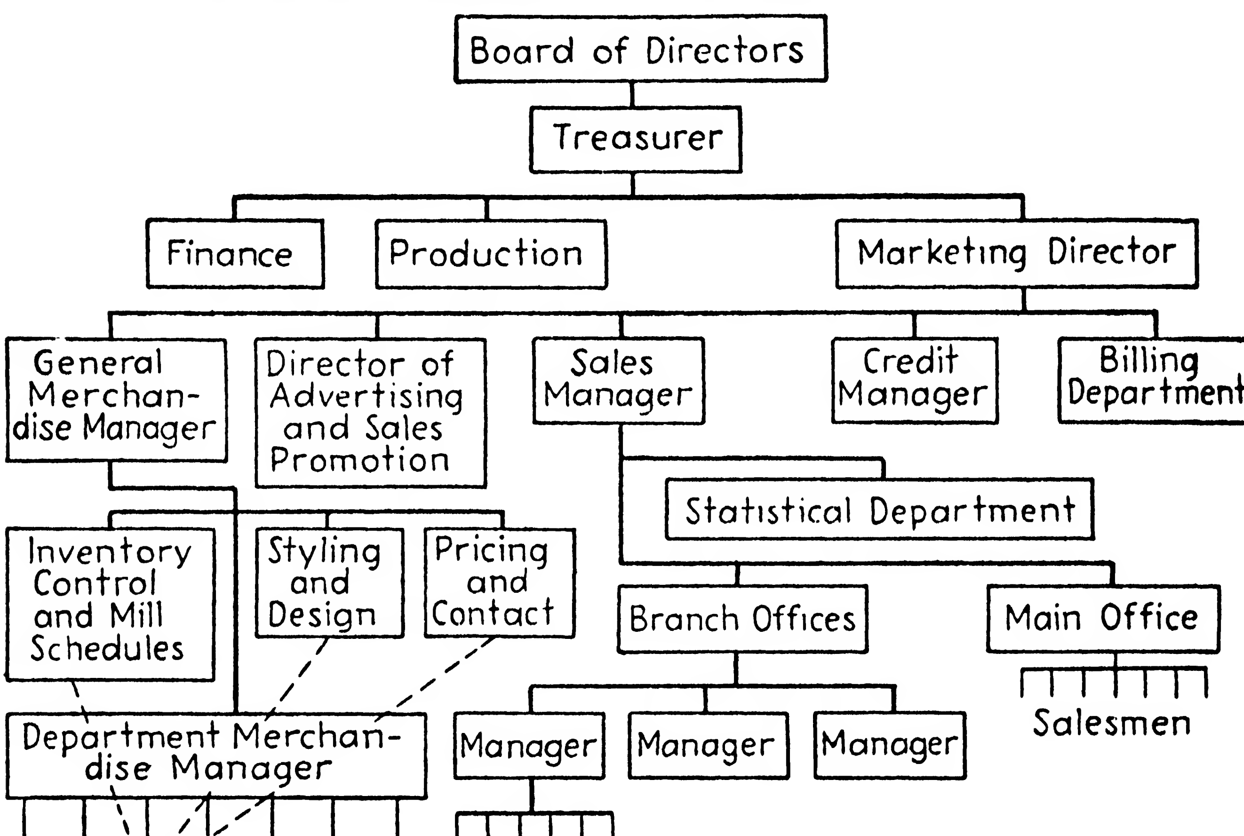
The Stubbs Company secured specialization in sales administration by employing a sales manager for each major market outlet. One of the sales managers, for instance, supervised the selling activities for the industrial market. The other sales managers directed sales of consumers' goods in particular segments of the consumer market.

The district offices of the Stubbs Company were under the direct-line control of the marketing director, even though the technical supervision of the activities of salesmen within each office might be governed by several departmental sales managers. A single salesman in a district office, therefore, might be subject to the orders of several bosses. Actually, however, this danger was rather more theoretical than real because each salesman operated under a coordinated sales plan developed by the market planning department. Though some salesmen were under the joint control of one or more sales managers, a majority of the men in the district offices were segregated by lines or by type of market and therefore had the instructions of only one sales manager to follow. The Stubbs Company employed 130 salesmen.

The executives of the Stevens Company believed that the organization setup of the Stubbs Company could be applied successfully to the Cobb Company. Thus the sales manager of the Cobb Company would become a marketing director; the product planning functions of the existing merchandise departments would be grouped in one department similar to the market planning department of the Stubbs Company; and three sales managers would be appointed: one to direct the selling operations of Merchandise Department A; a second, Merchandise Department B; and a third, Merchandise Departments C, D, E, and F. The executives of the Stevens Company held the view that the task of a sales manager was to teach and that the proposed change would give the Cobb Company the advantage of specialized direction of personal selling, which, in their opinion, was more desirable than the existing product and

market specialization. The sales manager of the Cobb Company, on the other hand, argued that one man could supervise the sale of a diverse line of products to different markets more effectively than a single department head could direct merchandising plans for a wide line of products. In support of his stand he pointed to the experience of the Babcock Company, a large textile organization with sales in excess of $20,000,000. The marketing organization of the Babcock Company was as given in Exhibit 3.

Exhibit 3
Chart of Sales Organization of the Babcock Company



The sales manager of the Babcock Company confined his activities to the direction of the 60 salesmen of the company. He estimated the potential purchasing power of the market as a whole and of individual important customers; he fixed annual quotas for the salesmen and established the method of compensation for these men. In addition, he routed the salesmen to territories, to given types of customers, and to accounts requiring special attention. Some salesmen of the Babcock Company represented only one line of product or sold to but one trade. When the volume of sales to an individual trade was large enough in a given territory to warrant the full time of a salesman, a single salesman specialized on that trade, carrying such lines as that trade bought. In cases where the

potential volume of sales of each line was smaller and the customers not so highly concentrated by trades, each salesman called upon several trades and carried a variety of lines. In the latter type of territory, a salesman might sell bleached goods to wholesalers, and wash goods to cutters-up and perhaps to retail stores, whereas in a large center, such as New York, a salesman called only on cutters of women's dresses.

Another feature of the Babcock plan was the separation of the advertising and merchandising functions from the function of sales management. The director of advertising and sales promotion supervised the company's trade advertising and field demonstrations. The general merchandise manager of the Babcock Company coordinated the merchandising policies of all the departmental merchandise managers and had on his staff and at the service of the department merchandise managers three staff experts: one on inventory control and mill schedules, one on styling and design, and one on pricing and contact. A department merchandise manager, on whom final authority for the product of his department fell, could call upon the staff assistant for pricing to help solve the price problems confronting the particular merchandise department. Similarly the stylist of the staff could be used for style advice, and the inventory control and mill schedule member of the staff worked closely with each department head in planning the production schedules. The credit and billing departments reported directly to the marketing director. The billing department was under the functional supervision of the controller of the company. The statistical department, for purposes of line control, was under the direction of the sales manager, since the department worked primarily with sales statistics.

Should the marketing organization of the Cobb Company have been modified as proposed?

2. NATIONAL THEATER SUPPLY COMPANY

INVENTORY CONTROL

The National Theater Supply Company was a wholesaler of theatrical equipment and supplies. In 1932, officials of the company became aware that inventories were being increased although

sales were declining. They therefore established a stock control department, which, in the ensuing three years, reduced the inventories at branches by 50% and established several new procedures designed to keep the inventories under control.

The National Theater Supply Company had been organized in 1926 through a consolidation of 50 local distributors of theatrical equipment and supplies. The offices of some of these firms were closed immediately. The largest number of branches operated by the National Theater Supply Company at any time was 30, and by 1935 the number operated was 28. In several instances the former owners of the various distributor companies absorbed by the consolidation had been retained as branch managers, because of their experience and local contacts. The purposes of the consolidation were to secure the usual advantages of large-scale organization and to serve more efficiently the large chains of motion picture theaters. The products sold by the new company included projectors, projector mechanisms and parts, ticket machines and tickets, sound-effect equipment, generators and transformers, carbons, lenses, lobby and poster frames, screens, ventilating equipment, lighting fixtures, incandescent lamps, furniture, carpeting, drapery and scenery, stage rigging and lighting, signs, and miscellaneous supplies.

The company's purchasing agent made all arrangements with manufacturers concerning prices and terms of sale before any branch orders were sent to them. These manufacturers made shipments direct to the branches of the National Theater Supply Company. The latter did not maintain central stocks, because it had found that it received favorable prices without operating a central warehouse.

The company followed a general policy of decentralized control, and branch managers were allowed considerable freedom in purchasing and in regulation of inventories. It was expected that they would work for the best interests of the company, especially since their compensation was based in part on the net profits of their branches. The managers were allowed to purchase direct from any manufacturer on the company's approved list. Purchase orders were not reviewed by the home office before being sent to the manufacturers. Under this system, branch managers had been able to accumulate inventories without any effective check by the home office.

The officers of the company became aware of the lack of inventory control when they observed, in 1932, that, although sales had been declining for several months, inventories had been increasing and the company's working capital was already suffering impairment. It was apparent that some degree of centralized control over inventories was essential. Accordingly, in October, 1932, the officials organized a central stock control department. The personnel comprised a department manager, an assistant manager, a stenographer, and five men who analyzed sales and purchases in order to obtain figures for use in setting quotas and in keeping a quantity check on the perpetual inventory of important items in each branch.

The members of the new department took steps as rapidly as possible to reduce inventories. They first selected from a total of over 5,000 product items the few hundred which accounted for a large part of the total investment in inventory. They then made a study of the unit sales of the selected items from the duplicate sales invoices for the first few months of 1932. On the basis of the study, these items were divided into two groups. All items in the first group were rated as too slow-moving to be carried in stock any longer at the company's branches. The second group consisted of regular stock items. For each of the items in this second group, a maximum stock limit was established. At the outset the limits were arbitrarily fixed at a 30-day supply; gradually they were replaced by more carefully adjusted stock quotas. At the same time, all branch orders were made subject to review by the home office.

A marked reduction in inventory was effected at all branches by the elimination of the slow-moving items from the regular branch stocks. These items, as revealed by the examination of sales invoices, were sold infrequently. Furthermore, customers did not usually require such quick delivery as to necessitate that the items be carried in stock at the branches. Branch managers were provided with lists of the items in this group and were instructed to send stocks of these items to the Chicago warehouse, from which deliveries would be made until the supply was exhausted. Thereafter managers were allowed to order from manufacturers only to fill definite customer orders. At frequent intervals they were furnished with reports showing the quantities of each item on hand in the excess stock at Chicago.

The establishment of maximum stock limits for all the products in the regular stock group brought about a further reduction in inventory. From the unit sales records of previous years the stock control department determined what stock of each of these items was required by each branch for the average 30-day period. The stock figures so determined were forwarded to each branch manager, accompanied by instructions not to reorder any item on the list until the branch stock was below the 30-day figure and not to order more than was necessary to bring the stock of the branch up to the 30-day limit. Under this program, excess stocks gradually were reduced by withdrawals for sale.

As soon as time permitted, the stock control department developed a set of stock quotas to replace the hastily set 30-day stock limits. The new stock quotas were based on a careful study of number of units sold, regularity of sales, customer delivery requirements, and the time which elapsed between placement and receipt of an order. The regular stock items were grouped in three classes: (1) items which required a large investment in inventory, (2) items subject to rapid technical changes, and (3) items, such as incandescent lamps, which might easily be stolen and which had a wide market outside the theatrical field. Under the revised stock quotas, the maximum inventory figures were generally increased from a 30 to a 60 days' supply.

For the three classes of quota items, the company kept at the home office a unit perpetual inventory record for each brand. Additions to balances on hand were the result of posting quantities shown on carbon copies of purchase orders, and subtractions from balances were taken from carbon copies of sales invoices. No perpetual inventory records were kept at the branches.

Branch managers were given quota sheets to be filled out at the end of each month. These sheets listed all the quota items, with quota figures. Two columns were provided, in order that the stock clerks might enter the quantity of each item on hand and the balance required to bring the stock up to the quota figure. The quantity of quota items on hand was determined by a physical inventory taken by stock clerks at the end of each month. The difference between the quota and the balance on hand was what the branch managers then ordered, to bring the stocks up to the quota figure. In some instances the most favorable discounts from manufacturers were to be obtained only on purchases of larger

quantities. Under these circumstances the minimum for discount purposes was ordered. Branch managers sent to the home office duplicates of their completed quota sheets.

Along with the measures designed to bring inventories within limits, the stock control department instituted revisions of some aspects of the purchasing procedure. Under the new plan whenever purchase orders were sent to manufacturers, carbon copies of the orders were sent to the stock control department, where they were immediately checked. If the branch was found to be ordering slow-moving merchandise or ordering too great a quantity of regular merchandise, steps were taken at once to correct the apparent errors. Usually the manager of the stock control department wired manufacturers to hold up shipments until the order could be reviewed with the branch concerned. When the quantities ordered were deemed excessive, the department asked the branch manager either to reduce them or to give a satisfactory explanation of his need for the larger quantities. Orders for products not previously carried were delayed until the branch manager could show that there was a demand for such products. When there was a known overstock of certain items in the branches, new orders had to be sent to the stock control department for approval. Through this procedure surplus stocks in some branches were reduced by shipments to other branches.

Orders for regular stock items not on the quota list were questioned only when the quantities ordered appeared to be excessive. The stock control department had set no definite standards for these items because the inventory investment involved was usually small. The men in the department, however, were sufficiently aware of the rate at which these items sold so that they immediately recognized an order for an excessive quantity.

The measures for controlling inventories of quota stocks were supplemented by additional checks. Branch managers were required to take an inventory of their stock of used equipment periodically. These figures were reported separately from the stock figures for quota items. Branch managers also had to take a quarterly inventory of their complete stock. The quarterly figures provided a check on the regular stock items that had not been placed on the quota list. A final check was made by the company's traveling auditors, who took an inventory of selected items to verify the perpetual inventory kept at the home office.

By July, 1935, the executive in charge of the stock control department believed that he had obtained effective control over the total dollar value of inventories. He had reduced total branch inventories from $1,200,000, in late 1932, to $600,000, in 1935. Over 800 items had been placed on the quota list. The quota system, moreover, had sharply reduced the number of branch purchase orders by replacing frequent small orders for these quota items with monthly orders. The working of the control system had become routine with the exception of a gradual revision of some of the quota figures first set and the establishment of quota figures for some additional items.

The work of securing control over dollar inventories had been so time-consuming that, up to July, 1935, the stock control department had not been able to give attention to the other problems of product control. There was no effective check on orders for new items. Executives found difficulty in inducing branch managers to add new items or to discontinue old items, with the exception of major equipment. Branch managers were also reluctant to shift used equipment from one branch to another.

The problem of adding and discontinuing products was not a serious one in so far as major equipment was concerned. The executives at the home office themselves kept in touch with technical changes affecting major equipment, and they tested new equipment as soon as it was perfected. When they foresaw that a new type of equipment would make obsolete a type carried in stock, they advised branch managers to refrain from further orders and to sell their remaining stock of the old type as rapidly as possible.

The addition of new products other than major equipment was initiated largely by the branch managers. They were called on frequently by manufacturers' salesmen who interested them in new products. As a result, branch managers sent in numerous orders for products which the company had never sold before. These orders were scrutinized by the stock control department; but this examination was superficial, since no definite standards for judgment were available. Even when an order was held up for investigation, the department was guided mainly by the branch manager's explanation. A branch manager typically explained an order for a new product by saying that there was a demand for it in his territory. The home office had no means of checking effectively either the existence or the extent of such a demand. As

a result, branch managers selected new products without much supervision or restriction. The stock control department, however, was able to check the actual sales of a new product by referring to the quarterly inventory reports.

The problem of controlling the addition of new products other than major equipment was apparent from an order received in 1935 from one of the branches. The order included a requisition for a large stock of repair parts for amplifiers used with sound pictures. Since these parts never had been carried in stock and seldom had been ordered by customers, the manager of the stock control department held up the order and asked the manager of the branch for an explanation. He replied that there were 50 sound-equipment installations in his territory for which there was no satisfactory repair service. The local electrical firms charged high prices and did poor work. He stated that a stock of repair parts would enable his branch to furnish good repair service at reasonable prices. The order was approved and sent to a manufacturer with whom the purchasing agent had made the necessary arrangements as to terms.

The home office had never required all branches to carry new products taken on by one or more branches. Under the existing policy, there was no way, for instance, of persuading the other branch managers to carry a stock of amplifier parts and to offer repair service. Some branches, furthermore, sold considerable curtain-control apparatus, whereas other branches had never sold such apparatus. In these cases the home office forwarded a record of the experience of the successful branches to the other branches, but usually the latter did not place orders for such products.

A similar problem arose when the stock control department attempted to discontinue an old product because of a newly developed one. When one branch ordered a new brand that was believed to be superior to the one being carried, the stock control department notified the other branches and suggested that they change to the new brand. The other branches typically continued to order the old brand. Any effort to make the branches change products or brands was resisted on the ground that their customers preferred the old items.

An additional unsolved problem existed with reference to used equipment taken in trade. There was an active demand for used equipment and usually a limited supply. When one branch had a

chance to sell a piece of used equipment but had none in stock, it tried to obtain the equipment from one of the other branches, either directly or through the stock control department. Such requests typically were refused for the reason that the equipment was "practically sold." The basic difficulty was that branch managers considered a transfer to be a no-profit sale because the transfer was made at inventory value. They preferred to hold the equipment for a sale which would yield at least some gross profit. The possibility that a drop in sales price might affect their profits adversely had little influence on their attitude toward transfers of used equipment.

The following case was illustrative of the failure of the home office to effect transfers of used equipment from one branch to another. In July, 1935, the Boston branch had a customer's order for three pairs of Peerless low-intensity arc lamps. Because he had none in stock, the branch manager secured one pair directly from a near-by branch and requested the stock control department to secure two more pairs. The inventory sheets showed that two distant branches each had two pairs in stock. Each of these branches was requested to send one pair to the Boston branch. One branch replied that both pairs were "practically sold," and a similar answer was expected from the second branch.

In more than one instance a substantial loss of business was thought to have resulted because transfers of used equipment could not be effected. A customer, for instance, who ordered used equipment frequently was engaged in refitting an old theater. Hence he did not want to invest in new equipment until he had determined the earning power of the theater. When such a customer could not obtain used equipment from the local branch of the National Theater Supply Company, he sometimes placed his entire order with a competing supplier. This circumstance, in the belief of company officials, might mean not only the loss of a large order but the permanent loss of a profitable customer.

The stock control department had rejected a suggestion that all stock of used equipment be kept at a central point, for the reason that the cost of double shipments would average almost 20% of the selling price of the used equipment.

Should the executives of the National Theater Supply Company have taken any further action with respect to the inventory control

system? From the standpoint of a branch manager, what suggestions, if any, should have been made?

3. TARPON COMPANY

RELATION OF ACCOUNTING TO THE STATISTICAL CONTROL OF SELLING OPERATIONS

The Tarpon Company manufactured and sold nationally to wholesale and retail grocers several products which were in general household use. In 1919 the company appointed a controller to coordinate the accounting activities of the organization with a view to the preparation of reports which would show the executives the significant results of the company's operations.

The general officers and the directors of the company desired a formal profit and loss statement in consolidated form only, but they wished information to be available which would permit analysis of the results of each of the two product-group departments. No expense budgets were maintained, either for any particular department or for the company as a whole, and it was not proposed that such budgets be established.

Factory costs and expenses were compiled separately for the two divisions into which the company grouped its products; these so-called product-group departments occupied separate buildings and used different raw materials. No difficulty had been experienced in accumulating separate factory cost data for the two departments, and it seemed desirable that at least an estimated profit and loss statement should be compiled for each.

For some years the general sales manager had maintained territorial sales and expense records, which in his opinion formed a satisfactory basis for control of individual sales districts. Those records were compiled from reports which passed through the sales department for approval before being sent to the accounting department for recording on the general books of account. The general sales manager held his district sales managers responsible for the detailed supervision of their districts, and he desired to make regular examinations of reports in summary form only. It had been his view that separate figures for each type of expense incurred were of no value to him in gauging the effectiveness of the

several sales districts. He also preferred that his district sales managers should maintain control by means of frequent visits to their territories and by their personal sales activities among the more important customers, rather than through the examination of a large number of detailed reports from the salesmen.

It was necessary for the controller to develop a classification of selling-expense accounts for the profit and loss statement of the business as a whole in order to facilitate general control by the officers and directors. He also had to decide, in accordance with the profit and loss statement classification, in what proportions he should allocate the expenses to the product-group departments to permit detailed analysis of the profits or losses obtained by each department. Inasmuch as the general sales manager already had developed records of sales and selling expenses, two of the major problems which the controller faced in developing the control division were the extent to which the expense classifications used by the sales department should be followed by the accounting department and the extent to which records prepared by the control division should duplicate or replace the sales records already maintained in the general sales office.

Not only the sales activities of the company but also the advertising and other sales promotion activities were under the direct supervision of the general sales manager, who was responsible to the general manager and the board of directors. The general sales manager was aided by an assistant general sales manager, an advertising manager, and 20 district sales managers. Under the supervision of the general sales manager, the advertising manager had complete charge of the administration of the advertising and sales promotion policies of the company. Each district sales manager had direct charge of a group of salesmen in his district and general supervision over canvassers, window trimmers, and demonstrators, who assisted the salesmen in promoting sales. The company employed about 250 salesmen.

District sales managers were expected not only to supervise the selling and clerical activities of their districts but also to call in person on the more important wholesalers and chain store buyers in their districts. The district sales managers hired their own salesmen, the number of salesmen permitted in each district depending on the population of the district. Company regulations specified the number of sales assistants to be allotted to each salesman;

in general, the hiring of such assistants was left to the judgment of the salesmen.

No separation was made in the sales organization either for the individual products or for the two groups of products; each salesman sold the full line of articles manufactured by the company. The general sales manager, therefore, did not wish to have sales control information classified separately for the product-group departments. He deemed it important, however, that the information should be classified by sales districts, in order that comparisons might be made among the several districts and that each district sales manager could be held responsible for results in his own district.

The sales policy of the company provided for distribution through wholesale grocers rather than directly to retailers, in the southern and western sections of the United States, where retail grocery stores were comparatively scattered. In the North, however, a number of cities were known as "direct-selling points," and in those cities Tarpon salesmen sold directly to retail grocers. In direct-selling cities the bulk of the company's sales were made direct to retailers, although in each city some sales were made to wholesalers who supplied either the small metropolitan retail stores or stores located in suburbs; in direct-selling cities Tarpon salesmen accepted no orders from retailers to be turned over to wholesalers. In the southern states, where the company did not sell directly to retailers, Tarpon salesmen regularly solicited orders from retailers for the accounts of wholesalers. In a number of cities throughout the United States sales were made to chain store companies. In direct-selling points each salesman had a territory in which he solicited orders from retailers, whereas in nondirect-selling territories each salesman had a list of retailers among whom he did missionary work and a list of wholesalers from whom he solicited orders.

At the direct-selling points the company maintained a staff of workers to make collections from the retailers to whom the company had sold direct. The company's policy of refusing to sell to retailers until they had paid for their previous purchases made it essential for the collectors and the salesmen to maintain close contact and for the collectors to be under the general supervision of the district sales managers. The controller rather than the district sales managers, however, exercised final authority

over the district credit offices. In direct-selling cities the company made free deliveries to retailers in quantities of five cases or more.

Practically all orders for carload lots were shipped from the factory. Orders which the company accepted from unit stores in direct-selling cities, as well as orders for less-than-carload lots accepted from wholesalers or chain store companies in direct-selling cities, were filled from stocks maintained by the company in public storage warehouses in those cities. Less-than-carload orders from wholesalers and chain store companies in nondirect-selling cities were filled either from district warehouse stocks or from the factory, depending on the relative accessibility of the stocks to the customers' cities.

District warehouse stocks were under the control of the traffic department, which was located in the general offices of the company. This department also had charge of the movement of stocks from the factory, both to warehouses and to customers, and of deliveries from warehouse stocks to customers. Invoicing always was done at the point of shipment of the products ordered. The company in a majority of its sales districts did not maintain its own delivery equipment but patronized local express companies.

The principal reports used by the sales department were a daily sales summary, expense summary sheets, monthly sales analyses for the district managers, a monthly sales report for the general sales manager, and district quarterly cost-to-sell reports.

From the totals of the salesmen's daily sales reports assembled in the office of the general sales manager, a daily sales summary was prepared on a form which showed for each style of packing of the products the total orders recorded for the day in number of cases according to the type of sales territory. Monthly sales analyses were prepared for each sales district by the statistical department at the central office; these analyses showed, by towns, for each product, the number of cases of each size delivered from either factory or district stocks. These reports were completed as rapidly as possible following the close of the month and usually were in the hands of the district sales managers by the twentieth of the following month.

At the end of every month each district sales manager compiled a report of sales and expense for salesmen in his district during the month. The original of this report was forwarded to the general sales manager, and a copy was filed in the district sales

office. When the district sales manager had completed his report of salaries for the month, he had data available from which to compute the comparative results of each salesman. Copies of the salesmen's daily reports on file in the district sales office showed orders secured. Expenses of salesmen and of canvassers and other assistants were available from the salesmen's semimonthly expense reports. From this material a clerk in each district sales office compiled for each salesman the monthly sales and expense record.

An expense summary sheet was also maintained in the office of the general sales manager for each salesman and for each district sales manager. The sheets provided space for each item of personal expense, grouped by months. To these summary sheets also were posted the totals of each of the expenses reported by the salesmen for their assistants, such as window trimmers and canvassers, and for automobiles, under the salesmen's control, used in selling and sales promotion activities.

The monthly sales report was instituted at the suggestion of one of the district sales managers. The purpose of the report was to provide closer acquaintance by the general sales office with the work of the individual salesmen. This report was filled in daily at the district sales office for each salesman from the data on his daily sales report and showed, in quantities for each product on the basis of the principal class of packing of the product, summaries of the orders received from wholesalers, the orders taken from retailers and accepted by wholesalers, the sales made direct to retailers, and the orders received by mail or telephone; chain store companies were included under the designation "retailers." Orders received by mail or telephone, including those for drop shipments, were credited to the accounts of the salesmen in whose territories the customers were located. The monthly sales report of each salesman was mailed at the end of the month to the general sales office.

Although the company did not budget expenses, the general sales manager set a sales quota, in cases, for each product for each sales district; and the district sales manager prorated this quota to the salesmen in the district. The quotas were entered on the monthly sales reports for use in checking operating results.

For a number of years the general sales manager had had compiled for each sales district a quarterly cost-to-sell report, which showed the relationship between the orders secured by

salesmen in that district during the quarter and the total expenses incurred by the salesmen and their assistants, as well as the other direct selling and sales-promotion expenses incurred within the district, during the period. The form for this report was as shown in Exhibit 1.

EXHIBIT 1
TARPON COMPANY
Form for District Quarterly Cost-to-Sell Report of Sales Manager

Sales (orders taken)

Expenses:

Salaries and Expenses:
Salesmen's Salaries and Bonuses
Salesmen's Railway and Hotel Expenses
Salaries and Expenses of Canvassers, Window Trimmers, and Other Sales Assistants
Office Salaries and Expense
Local Advertising (cooperative newspaper advertising with retailers)
Coupons Redeemed
Cost of Advertising Matter (mostly window and counter displays)
Automobile Expense (including depreciation)
Other Expenses (specified)

Total District Selling Expense

One of the company's principal methods of sales promotion was the distribution from house to house of coupons, which, under stated conditions, were redeemable at retail stores for standard-size packages of the company's products. The company's salesmen collected the redeemed coupons from the retailers, and the company reimbursed the retailers for the merchandise which they had given to consumers in exchange for the coupons. The cost to the company of this type of sales promotion, therefore, included not only the expense of the distribution of the coupons by the canvassers, which was included with salesmen's expenses, but also the redemption expense for merchandise given out by retail grocers in exchange for the coupons. It was the redemption expense which was included in "Coupons Redeemed" on the cost-to-sell report.

Information for the heading of "Automobile Expense (including depreciation)" on the cost-to-sell report was secured from the automobile department and represented not only the expenses reported by salesmen and district sales managers on the monthly automobile expense report forms but also the interest and deprecia-

tion on those automobiles, which were computed in the office of the automobile department. Since transportation, delivery, and warehousing were under the control of the traffic manager, the general sales manager did not include delivery expense in the cost-to-sell report. Similarly, credit and collection expense, for which the credit manager was responsible, was not included in the cost-to-sell report.

The cost-to-sell reports usually were available within 20 days after the end of the period covered.

Beginning in 1926, the general sales manager was made a member of a newly formed executive committee, which consisted of the general officers of the company and all major department heads. All members of this executive committee received quarterly profit and loss statements prepared by the controller.

In developing the profit and loss statement, the controller, in agreement with the general officers of the company, had taken the view that the company's activities naturally fell into two groups, activities of production and activities of distribution, and that all the company's expenses were incurred for the benefit of one or the other of these divisions and consequently should be charged to them. The production or factory division was charged with the costs of producing and packaging the company's products, including raw materials, factory labor, other direct expenses, factory warehousing, and all indirect or overhead expenses which were attributable to preparing the products for sale. Expenses for selling, sales promotion, shipping, district warehousing, traffic control, credits and collections, and related activities were regarded as properly chargeable to the sales division. All general administrative expenses not fairly chargeable to the factory division were charged to the sales division as part of the cost of marketing. The total nonfactory expense was known as "Total Selling and Administrative Expense."

All directors of the company were actively engaged in administrative activities; by agreement among themselves, the controller was furnished with a schedule showing the proportions of their individual salaries which should be charged to the factory division and the sales division, respectively. This proration was based on the approximate concentration of the directors' and general officers' time on the work of the two divisions.

In developing the "Total Selling and Administrative Expense" segment of the profit and loss statement, the controller tried, in so far as possible, to follow the general plan already in use by the

EXHIBIT 2
TARPON COMPANY
Form of Profit and Loss Statement

Net Sales

Manufacturing Cost and Expense

Manufacturing Accounts in detail, including:
  Purchases of Raw Materials
  Direct and Indirect Manufacturing Expense (including Factory-Administrative)
  Inventory Adjustments
    Total Manufacturing Costs and Expenses

Gross Margin

Selling and Administrative Expense

General Sales Office: Salaries and Wages
Salesmen's Salaries and Wages
Salesmen's Expenses
Canvassers: Salaries and Expenses
Window Trimmers: Salaries and Expenses
Other Assistants: Salaries and Expenses
Sales District: Automobiles and Trucks
Sales District: Collectors
Commissions
Conventions
Supplies and Sundries
  Total Salesmen's Salaries, Expenses, etc.
Freight Outgoing
Rent, Storage, and Insurance
Traffic and Shipping
Stable and Garage
  Total Shipping Expense
General Advertising
Coupons
  Total Promotion Expense
Administrative Office
Executive
  Total Administrative Expense
    Total Selling and Administrative Expense

Net Profit

sales department for the district cost-to-sell reports. On the profit and loss statement, however, it was necessary to include additional expenses which the general sales manager excluded from

his reports on the ground that they were not within his control. The controller established accounts not only for selling departments but also for auxiliary departments, known as "indirect departments," such as traffic and shipping, stable and garage, accounting, statistical, and other administrative office departments. It also was necessary to provide for the inclusion on the profit and loss statement of such charges as taxes, insurance, equipment, repairs, and similar expenses, which, while not incurred directly by the sales division, were deemed to be chargeable to it.

"Total Selling and Administrative Expense" on the profit and loss statement was subdivided by the controller into four major groups of expenses: "Total Salesmen's Salaries, Expenses, etc."; "Total Shipping Expense"; "Total Promotion Expense"; and "Total Administrative Expense." The subdivision of these groups is shown in Exhibit 2.

The account for "Sales District: Automobiles and Trucks" included operating expenses, insurance, taxes, and depreciation on all automobiles and trucks used in the district. Expense for hired truckage employed for delivery was included in "Freight Outgoing."

The quarterly profit and loss statement and analysis of results prepared by the controller usually was in the hands of the members of the executive committee approximately 45 days after the close of the fiscal period, although most of the basic data were available in 30 days. The relatively slow compilation of this complete accounting report as contrasted with the general sales manager's specialized cost-to-sell reports resulted from the necessity of closing the books for the period, summarizing the inventories, and making the quarterly expense distribution for such accounts as "Rent," "Insurance," and "Taxes" to the departmental accounts, such as "Statistical," "Advertising," and "Traffic," and eventually to the summary accounts as they appeared on the profit and loss statement. The adjustment of inventory data and the fact that the profit and loss statement was compiled from regular ledger accounts, which required balancing, were stated as the principal reasons for the difference between the time required for preparation of the cost-to-sell report of the general sales manager and the availability of the basic data of sales cost for the company as a whole as shown by the profit and loss statement.

In 1926, shortly after his appointment to the executive committee, the general sales manager stated that, although the profit and loss statements undoubtedly were necessary for the general officers of the company, they were of slight value to him in controlling sales activities, inasmuch as the profit and loss statements were the result not only of sales activities but also of manufacturing operations, were based on invoices rather than on orders received, and did not segregate charges which were controllable by himself or by his district sales managers. The controller stated that it had been his conviction for several years that quarterly profit and loss statements should be prepared by his department for each of the company's sales districts. It was his opinion that the general officers and directors of the company should have available for each district not only the information shown on the cost-to-sell reports of the general sales manager but also those data which were excluded from the cost-to-sell reports but shown on the profit and loss statements. The controller hoped that eventually the control division would take over the work of compiling records which at that time were accumulated in the general sales office. He argued that sales and sales expense reports, even though used only for controlling district sales activities, should be tied in with the accounting records of the company and that all accounting and statistical reports should be centralized in the one control division. He was convinced that with his program in operation less confusion would result from discrepancies between different sets of records, and facility of control on the part of the general sales manager would be strengthened rather than weakened.

Which point of view should the management have accepted, that of the general sales manager or that of the controller? What action should have been taken?

IX

PRICE DETERMINATION

1. RADIO INSTRUMENT COMPANY

PRICING A NEW PRODUCT

The Radio Instrument Company was organized in 1925 to manufacture and market a recently patented device known as a "weightmeter." The weightmeter was an electrical instrument so designed as to indicate the variations in weight or moisture content of moving sheets of materials during the process of manufacture. The materials that could be so measured included sheet rubber, tire fabric coated with rubber, shoe lining, paper, celluloid, roofing, and sheet metals. Weighing of sheet material in the process of manufacture ordinarily was done by mechanical methods, but the resulting measurements frequently were crude and inexact.

As research and experimentation with the weightmeter progressed, it became evident that the device could effect a considerable saving in manufacture and could help in standardizing the quality of products in the rubber, paper, textile, and other industries. The value of the weightmeter to users would vary widely according to use. This fact complicated the company's problem of pricing and marketing its product.

In its operation, the weightmeter depended on the working principles of a radio receiving set. The inventor had noted when operating a radio set that a sheet of paper or other material placed between the condenser plates caused a change in the tuning of the set and, furthermore, that the variation in the tuning increased as the quantity of the material inserted was increased. Realizing that this phenomenon might be utilized in industry as a means of checking weights of materials, he developed a machine whereby a sheet of moving material whose weight was to be checked could be passed between the condenser plates of a radio hook-up. The machine did not record the weight of the material in pounds or other units as it passed between the plates of the condenser but showed variations from a standard for which the machine was set at the time. In other words, the machine worked on the principle of matching standard samples.

A needle, called the "indicator," which could move from left to right over a calibrated scale, was connected to an electrical circuit containing the condenser plates between which the moving sheet of material passed. The indicator corresponded to the loud-speaker in a radio receiving set. The standard sample placed between the condenser plates determined the natural radio frequency of the circuit and thus its degree of response to an impressed radio frequency. A dial connected with a compensating condenser in the same circuit could be tuned so that the indicator would point to zero on the calibrated scale. When the indicator pointed to zero, the reading of the dial furnished a permanent record for the setting of the machine to the control point for material in process which was to match the sample. A variation in weight of the material passing between the condenser plates thereafter would cause the indicator to vary to the right or left from the zero mark on the calibrated scale. The amount of variation as shown on the scale would permit determination of the variation in weight from the standard sample.

In a rubber factory, for instance, the weightmeter was attached to a rubber calender so that the sheet of rubber stock passing through the calender moved between the condenser plates of the weightmeter, which was set according to the sample of material to be matched.[1] The operator could adjust the calender rolls when the indicator showed that the weight of the material was running either above or below the standard. The indicator responded to very slight variations in the weight of the substances. For example, by the use of the weightmeter, inner tube stock for automobile tires could be kept at less than 1% of variation from the desired weight, and tire fabric could be kept at about 1%.

Experiments with the device first had been undertaken in a paper mill as a means of checking the weight of a moving sheet of paper in the process of manufacture. By the end of 1926, it had been found that the device could be used not only in controlling the weight of the paper but also in controlling the moisture content of the paper as it came from the calender. A paper machine,

[1] A typical rubber calender consisted of a large frame which supported three hollow, steam-heated rollers placed in a vertical plane one above the other. Between the rollers a strip of fabric was run; and into this fabric, as it passed between the rollers, rubber compound was pressed. The rollers could be adjusted so as to increase or decrease the distance between them, and this distance determined the thickness of the finished product.

therefore, could use two weightmeters: one to detect changes in weight and one to detect changes in moisture content. It was important that the moisture content of paper be kept as nearly constant as possible. This was true, in the first place, because paper manufacturing companies sold paper by weight and, in the second place, because variation from the desired moisture content, especially in newsprint, caused difficulty, waste, and annoyance when the paper was run through printing presses. Newsprint that was too dry, for instance, had a tendency to become charged with static electricity, which prevented smooth running through printing presses. A paper mill which could furnish newsprint with a standard moisture content had a valuable selling point. The existing methods of controlling the moisture content of paper were crude and subject to error. The weightmeter, however, indicated slight variations in the moisture content. An operative, by changing the steam in the drying rolls in accordance with the readings of the weightmeter, could hold the moisture content of the paper to a desired standard.

As the experimentation progressed, it became clear that eventually there would be developed automatic control devices to be used in connection with the weightmeter to control the weight and quality of goods in process. When the weightmeter was used with only an indicator, an operative had to watch the indicator for variations in weight of material in process and then adjust the processing machines to correct the errors. It was anticipated that attachments would be perfected by which the proper adjustments could be made automatically, without the assistance of operatives. Considerable work already had been carried on in the development of an automatic control attachment for calenders used in rubber manufacture; moreover, automatic devices had been developed and tested at an affiliated mill for use on paper machines to control the weight of paper run. It was expected that an automatic control attachment for the steam drying apparatus on a paper machine also would be developed. By the end of 1926, the company had developed a recorder which, when attached to the weightmeter, plotted a graph of the variations in weight of material.

The Radio Instrument Company planned to choose a representative firm in each of eight industries in which the weightmeter might be used, to cooperate in experimenting with the instrument under actual operating conditions. Thereby the company hoped

to determine the savings which the instruments would effect in the manufacture of different products in each industry. By the beginning of 1927, such experiments had been conducted in the plants of a rubber and a paper company.

The research engineers of the Radio Instrument Company stated that the probable savings from use of the weightmeters were both tangible and intangible. The savings which could be measured partially by experiments and on the basis of cost accounting records were (1) those that would result from reduction in quantity of raw material used, since, with accurate measuring, overweight of articles would be eliminated and (2) those that would result from increased production per machine-hour and per man-hour. Intangible savings would result from increased customer confidence and goodwill and from expected changes in process which would allow reductions in the number of operatives.

Through the cooperation of the rubber company, the Radio Instrument Company experimented with its machine in the various processes of manufacturing rubber tires and other rubber products, such as boots and shoes. As a result of this experimentation the research engineers of the Radio Instrument Company estimated that the use of the weightmeter in tire manufacture would result in savings varying from $100,000 a year for an unusually large calender to $10,000 a year for each of certain small calenders often used in rubber factories. On a relatively few calenders in rubber factories the engineers estimated that a saving of $30,000 a year per calender might be brought about. The use of the weightmeter on machines for manufacturing rubber products other than tires brought savings which were substantial, according to the Radio Instrument Company's research men, though not often so large as those for tire fabrication. The research engineers reported that the rubber company which was cooperating in the experiments probably could made effective use of 20 weightmeters. The engineers estimated further that if the 10 largest rubber manufacturers in the United States made full use of the weightmeter in their factories, 1,000 weightmeters would be required. According to the engineers, savings amounting to millions of dollars would result from such use of the machines.

The manufacture of inner tubes for automobile tires afforded an example of the savings expected to result from the use of the weightmeter. Inner tubes were sold to dealers as being of certain weights,

but commonly the tubes varied above or below those weights. A tire manufacturer had to keep the variations below the standard weights within certain limits in order to satisfy distributors and consumers. It was generally conceded by manufacturers of inner tubes that, inasmuch as there had been no effective means of measuring variations during the manufacturing process, there had been a tendency to make the tubes overweight in order to avoid any possibility of their being below the allowable minimum weight established for them. If the weightmeter were used, however, variations in weight could be kept within very narrow limits. Thus, the manufacturers could save in raw material.

In cooperation with the affiliated paper company the Radio Instrument Company had experimented for nearly a year with the weightmeter and had succeeded in developing a device for automatically controlling weight of paper in process on a sulphite bond and sulphite "linen" paper making machine. The estimated saving through control of the weight of paper was less than the saving from control of weight in the rubber industry, both because the raw materials entering into paper were less valuable than rubber and because the manual control already developed in paper manufacture was better than that in rubber manufacture. The Radio Instrument Company's engineers estimated that on a sulphite bond and linen paper machine the saving from the use of the weightmeter, in conjunction with the automatic devices, would be about $5,000 a year. The superintendent of the paper mill, however, maintained that perhaps the same results in the control of the weight of paper could be obtained by employing an operative whose sole duty would be to control the weight of the paper as it was run through the machine. Such an operative, he stated, would be paid not more than $1,500 a year. The engineers of the Radio Instrument Company, however, who were well versed in the problems of paper manufacture, asserted that the precise control of weight which they had demonstrated could not be attained except through the use of a precision instrument such as the weightmeter, and pointed out the fact that, although such control had long been desired, it had never previously been achieved.

In the paper industry, the savings for each machine from control of the weight of the paper would vary substantially with the quality and the quantity of the paper passing through the machine. The engineers of the Radio Instrument Company, however, roughly

estimated that the average savings would be approximately $5,000 a year for each machine equipped with a weightmeter and with automatic controls attached thereto.

Control of moisture content was as important in the paper industry as control of weight. One large manufacturer of newsprint had experimented unsuccessfully for several years trying to develop a hygrometer which could be used to control the moisture content of paper. Engineers and executives of this company estimated that ability to hold the moisture content constant would be worth $100,000 a year for each large modern newsprint machine of the company. One manufacturer of newsprint had six newsprint machines; most other paper companies had a smaller number. Newsprint machines were of enormous capacity. Savings to be realized through control of moisture content for other types of paper were not so large reckoned by machines. Nevertheless, the average potential saving for each such machine was estimated to amount to thousands of dollars a year.

The Radio Instrument Company recognized that the estimates of its research engineers might be subject to skepticism and disagreement on the part of the engineers and executives of the manufacturing companies which were potential users of its machine.

The Radio Instrument Company was a subsidiary of a paper manufacturing company. The executives of the subsidiary company had had no experience in the manufacture and marketing of precision instruments, and the company did not have factory facilities for the manufacture of such instruments. The first instruments with which the company experimented under operating conditions were assembled for the company by a manufacturer of electrical apparatus. Certain of the castings were made according to drawings and specifications provided by the Radio Instrument Company, but the rest of the device consisted mostly of standard radio and electrical parts. Officials of the Radio Instrument Company estimated that the instruments could be manufactured by the existing maker on order in lots of 100 or more at a price of $600 to $700 apiece, billed to the Radio Instrument Company. While some savings in manufacturing costs might be expected from increasing the volume of output of the machines, these savings would not be large. Moreover, the maximum number of machines which might be sold would be relatively small, so that saving by

quantity production was not a consideration in the manufacture and marketing of the device.

The basic principles of the invention were fully covered by patents not yet litigated, but apparently remarkably strong; and the company employed an able patent attorney and an engineer who was an expert in patent procedure to keep the new developments covered by patent applications.

The company's instrument had no direct competition. Other mechanical weighing devices had been on the market for several years, available for similar service in particularly suitable fields; but they were said to be complicated and delicate, lacking in precision even when new, and likely to go out of adjustment. These competing machines were sold outright for $1,500 each; but only a few had been sold, and some of these stood idle.

The executives of the Radio Instrument Company at first had planned to sell the weightmeters outright to users. They had discarded this plan, however, their reasons being that the number of the instruments needed in industry was limited, that new and important applications of the device constantly were appearing, that a price commensurate with the value of the instrument to an industrial firm might be so high that the firm would not purchase, and that the instrument did not have the same value to different industries or for different products in the same industry.

The executives also had contemplated leasing the instruments at a fixed rental. They had rejected this plan, however, because, if a uniform rental per machine were to be asked, that rental would have to be based on the instrument's value to manufacturers finding it least useful rather than on its value to those firms where it effected the largest savings.

The further suggestion had been made that the company sell the machines on a royalty basis with a uniform initial charge sufficient to cover the cost of manufacturing and installing the instruments and a royalty charge for each unit of product manufactured, the royalty charge to vary for different products in accordance with the value of the machine in their manufacture. In talking with officials of rubber companies, however, executives of the Radio Instrument Company learned that some, at least, of the rubber companies would object strongly to a royalty basis because they did not wish to release production figures. Manufacturing processes differed

among companies, furthermore, so that it was difficult to apply a uniform royalty to similar products of different companies.

The Radio Instrument Company also had considered placing the instruments with companies at a uniform initial charge plus an annual charge equal to one-tenth of the savings resulting from the use of the machines. The company, however, had encountered difficult cost accounting problems in an experimental attempt which it had made to determine definitely the savings resulting from the use of the instruments in the plant of the cooperating rubber company. It would experience difficulty also in arriving at agreements with users as to the savings effected. Processes in manufacturing were constantly changing, and the use of the instrument might cause further cost-reducing changes, the savings from which could not be attributed entirely to the weightmeter.

The president of one rubber manufacturing company whom the executives of the Radio Instrument Company approached was of the opinion that the Radio Instrument Company should not base the price of its machine on probable savings to users. This executive held that the weightmeter was merely a precision instrument to indicate variation from standard and that any saving which was effected would depend on the use made of the information supplied by the weightmeter in controlling operating processes. He stated that, if the Radio Instrument Company developed automatic devices which of themselves would control manufacturing processes, then the company could expect to share in the saving effected.

In January, 1927, it appeared advisable to executives of the Radio Instrument Company to get into operation as many as possible of the machines with merely the indicator instrument and without the recording graph or automatic control devices. The executives were confident that a manufacturer had only to use the indicating machine to realize its value. They proposed to make an initial charge large enough to cover the costs of manufacture and installation and in addition to charge a fixed annual rental. The fixed annual rental probably would not be the same for different industries but would vary roughly in accordance with the value of the weightmeter in the industries. Whether there should be variation in rental charges among installations in the same industry was undecided. It was proposed to put into the contract with lessees

a provision that no recording devices or automatic controls were to be used in connection with the weightmeter except with the cooperation and express approval of the Radio Instrument Company. The company expected to make additional charges for the use of recording and control devices in connection with the precision instrument. Such charges, it was anticipated, would be varied in accordance with the value of the devices to users, so that the Radio Instrument Company would benefit in proportion to the economies effected. The inventor of the instrument already had worked out an automatically controllable rubber calender feed; and one had been built, but not yet tried out, as of January 1, 1927. The company planned to maintain an adequate repair service department and to provide expert repair service to users at cost.

What analysis of demand should the Radio Instrument Company have made before establishing prices?

2. THE GOBELIN COMPANY, INC.

REDUCTION IN PRICE IN ORDER TO INCREASE SALES

In each year from 1926 to 1932, inclusive, The Gobelin Company, Inc., (and its predecessors) had sustained a loss. In December, 1932, the president, in a last desperate effort to save the company, asked the directors to approve radical changes in policy. The principal product of the Gobelin company was a high-quality packaged candy which retailed at $1.50 and $2 a pound. The keystone of the president's program was the reduction in the retail price of Gobelin chocolates to 50 cents a pound. It was his contention that the total dollar volume of sales at the lower price would be more than triple what the company had attained at the higher prices. The increased volume, coupled with a simplification of the line, he believed, would lower the cost sufficiently to enable the company to operate at a profit.

The Gobelin Company, Inc., had been organized in 1929 to continue a candy business which had been established in Cambridge, Massachusetts, in 1890. Until the 1920's, the original organization had been successful in the manufacture and sale of high-quality packaged candy, bulk chocolates, and 5-cent bars. Thereafter

its sales had declined sharply as more aggressive companies invaded its market. The Gobelin company bought the assets of its predecessor but made no use of the established name; instead it concentrated on the manufacture and sale of high-quality packaged chocolates bearing the Gobelin name. In addition the company continued to produce hard candies, bulk chocolates, and 5-cent bars in order that overhead might be distributed over the largest possible sales volume.

Exhibit 1

Manufacturers' Sales of Chocolates in the United States 1927–1931*

	1927	1928	1929	1930	1931
	Millions of Pounds Manufactured				
Fancy Package Goods (retailing at $1 or more a pound)	46.2	44.1	42.7	33.7	26.4
Plain Package Confectionery (retailing at less than $1 a pound)	72.5	64.2	66.4	97.2	107.6
Chocolate Bulk Confectionery	144.0	142.6	137.4	106.3	109.9
Molded Chocolate Bars	102.2	112.6	112.1	100 2	83.0
Chocolate Covered Bars	255.4	262.4	351.8	371.8	330.5
Other Bars	63.0	51.4	59.1	48.3	44.1
	Average Wholesale Price per Pound				
Fancy Package Goods	76.3¢	74.1¢	76.7¢	77.4¢	76.9¢
Plain Package Confectionery	37.7	38.5	36.4	32.1	28.7
Chocolate Bulk Confectionery	24.8	24.8	24.2	23.4	19.2
Molded Chocolate Bars	33.4	33.0	32.3	29.9	29.0
Chocolate Covered Bars	20.8	21.7	19.5	17.7	16.2
Other Bars	21.1	21.0	20.3	19.6	17.6

* The figures for 1927, 1928, and 1929 are comparable among themselves but not strictly comparable with the figures for 1930 and 1931. The data for 1930 and 1931 are likewise comparable between themselves.

Source: U.S. Bureau of Foreign and Domestic Commerce, *Confectionery Distribution in the United States, 1927–1929* (Washington, Government Printing Office, 1930), and *Confectionery Distribution in the United States, 1930–1931* (Washington, the Bureau, 1932).

The name "Gobelin" had been selected personally by the president of the new company because he believed that its association with the finest tapestries in the world suggested to many people the highest standards of quality and craftsmanship. Through the design of the box and a distinctive type of advertising, the

president hoped that the connotation of high quality would be carried over from Gobelin tapestries to Gobelin candy.

The company made chocolates in two sizes: "opera" or "bite" size, running 150 to the pound, and the more usual size, running less than 50 to the pound. Two types of packages were marketed: one, the "Black Seal" package, containing only the bite size chocolates, retailed at $2 a pound; the other, the "Tapestry" package, containing an inner 2-ounce box of bite size chocolates surrounded by 14 ounces of the standard size, retailed at $1.50 a pound.

In the years following the formation of the Gobelin company, the onslaught of the business depression caused total sales of high-price chocolates in the United States to decrease markedly, as the figures in Exhibit 1 show. Measuring the success of the Gobelin policy was therefore difficult.

Officials of The Gobelin Company, Inc., together with those of many other companies in the industry, believed the depressed conditions to be temporary. The company consequently maintained its standard retail prices of $1.50 and $2 per pound. Sales volume, however, dropped steadily until 1932; and the company's annual deficits became larger and larger. Many competitors sold their plants and liquidated their companies, but even the lessening of competition did not stem the decline in sales of Gobelin chocolates. In September of 1932 it became apparent that for the entire year the company's sales through its 2,000 outlets would not exceed 150,000 pounds of $1.50 and $2 chocolates, plus 150,000 pounds of other candies, and that a deficit of approximately $65,000 would be incurred.

There appeared to be no alternative to the liquidation of the Gobelin company until the president made his proposal to sell high-quality chocolates for 50 cents a pound. The steps in the president's reasoning were as follows:

(1) He estimated that the Gobelin company's sales in 1932 would amount to 150,000 pounds of the main-line packaged chocolates and 150,000 pounds of other items, and that the company would sustain a loss of about $65,000 (see Exhibit 2).

(2) He believed that even if the volume of sales of subsidiary lines did not decline, the company would find it impossible to increase the sales of high-price chocolates sufficiently to overcome the loss. Sales of all high-price candies in the United States had declined sharply since 1929 (see Exhibit 1), and the Gobelin company was already spending $40,000 a year for advertising.

(3) He suggested, therefore, that the company abandon all its lines except the high-quality chocolates and offer these high-quality chocolates at a very low price. He realized that other companies were already selling low-price candy and that the Gobelin company would have to offer an outstanding value if the necessary volume was to be obtained.

(4) For a short test period during 1931, the company had put up a package of its regular candy to retail at $1 per pound, but the increased volume at the lower price had not been sufficient to offset the reduced margin. Apparently, then, the price of $1 a pound was not sufficiently

Exhibit 2
The Gobelin Company, Inc.
Cost Data, 1932
(Partly estimated)

Packaged Chocolates:	
Boxes	$ 24,000
Packing	6,000
Selling (15% of average selling price)	24,000
Material, Labor, and Production	67,500
Express	6,000
Display	7,500
Bad Debts and Loss from Returns	4,500
Overhead	64,500*
Total Cost	$204,000
Selling Price (150,000 pounds)	159,000
Loss	$ 45,000
Loss on Items Other than Packaged Chocolates	20,000
Total Loss	$ 65,000

* Overhead of $50,000 was charged to "items other than packaged chocolates." The total overhead of $114,500 was made up of Advertising, $40,000, and Administration, $74,500.

low to accomplish the desired results. The president personally did not believe that 75 cents was really a low price and therefore considered that either 60 cents or 50 cents would be the correct price. Many distributors and dealers already had 60-cent lines, and the new Gobelin package must not be considered as "just another 60-cent candy." Accordingly the 50-cent price was probably best suited to the proposal.

(5) He knew that even such a startling offer as $1.50 candy for 50 cents would not of itself produce a sales volume large enough to put the company on a profitable basis. Dealer cooperation must be secured. He believed that the large volume needed by the company could be obtained only by intensive coverage of the market, but he recognized that coverage of the market by a large number of outlets was of little use without vigorous sales effort by the dealers. On the other hand, although distribution through exclusive agencies would undoubtedly assure vigorous sales effort, it was improbable that the necessary volume could be obtained through a small number of outlets.

(6) He proposed, therefore, that the dealer's name be put on every box so that repeat sales would come back to the individual dealer. In

the experience of the candy industry, unless dealers were willing to contract for at least 8,000 boxes, the expense of putting their names on the boxes was prohibitive. But a rubber stamp had recently been perfected with which the dealer's name could be put on the box neatly and inexpensively. Since this stamping was to be done at no cost to the dealer, the company would have a threefold argument with which to enroll dealers for the new candy:

(*a*) The candy was inexpensive and therefore would appeal to a wide market.

(*b*) The candy which was to retail at 50 cents a pound actually was equal in quality to that which the company made to sell at $1.50 and $2 a pound.

(*c*) Repeat sales would come back to the dealer because his name was on the box.

As a corollary of these advantages, it was probable that the turnover of Gobelin chocolates on the dealers' shelves would be much greater than for candy which did not have these advantages.

With this outline of the plan before him, the president had proceeded to estimate the cost and the necessary volume under the new plan. With the aid of the production manager he estimated costs for a wide range of production volumes. He discovered that costs in most instances could not be lowered until about 1,300,000 pounds were produced in any one year and that, with the exception of those expenses which were fixed in total and therefore varied directly with volume, there was no further appreciable saving in production above 1,300,000 pounds. In fact, at a rate of production between 3,000,000 and 4,000,000 pounds a year, which was the physical capacity of the plant, costs probably would rise. He calculated that the costs listed in Exhibit 2 could be reduced as summarized in Exhibit 3 as soon as a volume of 1,300,000 pounds a year was attained. The cost estimates were believed to be approximately accurate until a volume of 3,000,000 pounds a year was reached; after that, they would increase slowly.

The economies with respect to the use of cheaper boxes, simpler methods of packing, and reduced selling, advertising, and administrative expenses were considered to be largely independent of volume. They would, however, depend indirectly on the attainment of a satisfactory volume of sales. For instance, the success of the proposed reduction in selling expense would depend largely on the ability of salesmen to maintain their income by increasing their volume. The remaining economies were dependent on volume to various degrees.

The president estimated that the volume required to break even could be obtained more easily with the lower selling price than with the high prices which had prevailed in the past.

In order to have some evidence of the possibility of attaining the necessary volume, the president, in November, 1932, introduced trial packages of the proposed 50-cent line in parts of New England. Within three weeks, the Gobelin company had succeeded in selling 30,000 pounds of the new packages to 300 stores, about half of which were new accounts. In many cases repeat orders had been received from these stores within 10 days; and the dealers were enthusiastic, both because of the rapid stock-turn and because the candy was being sold under their individual names, thus enhancing their prestige. With the idea of lessening the resistance of dealers to the purchase of the new package, The Gobelin Company, Inc., during this test period had refrained from using the Gobelin trademark on any part of the box. But it planned within a short time, if it continued in operation, to place a distinctive Gobelin trademark on the side of each package.

The president realized that November was the most important month of the year for sales of candy and that sales could not be expected to continue at this volume throughout the year. After a consideration of seasonal factors, however, he estimated that annual sales of the 300 dealers would be about 150,000 pounds, whereas the same number of dealers would not have been able to sell more than about 30,000 pounds per year of the $1.50 and $2 packages. Thus it was apparent to him that the company could sell five times as many pounds of the packaged chocolates as before without increasing the number of its outlets, since tests indicated that individual dealers could sell about five times as much of the new product as they had been able to sell of the old.

Furthermore, the company would no longer be expected to grant exclusive rights to dealers and would be able to sell to a greater number of stores in each area. Also, if successful, it would be able to extend its selling area into the Middle West and South Atlantic states. Therefore, total sales might be expected to be much more than five times as great as previous sales. The president believed that well-designed sales literature and display material would make comparatively simple the salesmen's job of interesting new dealers and that the number of dealers could be doubled within a year.

EXHIBIT 3

THE GOBELIN COMPANY, INC.

Summary of Costs at Volume above 1,300,000 Pounds a Year

Item	Comment	Estimated Cost per Pound
Box	In place of the fancy box in which the Black Seal and Tapestry candy was packaged, an inexpensive plain white box (stamped with the dealer's name) would be used	1½ cents
Packing	The cost of packing presumably could be reduced by substituting a simple arrangement for the elaborate one used in packing the expensive boxes	Slightly less than 1 cent
Selling	Selling expense could be reduced by lowering the rate of commission to salesmen. The prevailing commission was 15% of sales, or 15 cents for each box sold to dealers to retail at $1.50 per pound. The dealers paid $1 per box, the retail price less a discount of 33⅓%. It was proposed to sell the new 50-cent box to dealers at the same rate of discount, that is, for 33⅓ cents per pound, and to allow the salesmen a commission of only 8% of the price to the dealers. It was expected that many repeat orders for the new 50-cent package would be sent in by mail, rather than held until salesmen arrived on their regular scheduled trips as had been the previous general practice. It was not planned to compensate salesmen for mail orders from their territories. The men would continue to pay their own traveling expenses	Less than 2⅔ cents
Material, Labor, and Production	Material costs, according to estimates, could be reduced by the large-scale purchasing which would be brought about by the increased volume. Labor expense could be reduced in two ways, one directly, and the other indirectly, related to the increase in volume. First, when the company was producing only 150,000 pounds a year, periods of complete shutdown were required. The expense of training new workers each time the plant reopened was a heavy burden which could be eliminated by the continuous operation possible under large-scale production. The second labor economy, while indirectly related to volume was perhaps the more important. Under the old production schedule there was little specialization of labor. One worker performed many tasks. With production above 1,300,000 pounds a year and with the simplification of the product attained by dropping all lines except the high-quality chocolates the advantages of specialization could be enjoyed by a rearrangement of the machinery. It was planned also to make a drastic reduction in handling costs by the installation of	20 cents

EXHIBIT 3 (*Continued*)

Item	Comment	Estimated Cost per Pound
	mechanical conveyers. Fully two-thirds of the total savings in material, labor, and supervision costs would be accounted for by the more efficient use of productive labor, made possible by the large volume and the simplification of the line. Supervision costs were to be cut by designating the more experienced workers as group bosses or working foremen	
Express........	Shipments to dealers were to be made by express, as previously. Under the existing system, dealers commonly reordered the $1.50 assortment in small quantities, usually about 12 to 50 pounds. These shipments in a majority of instances were subject to the minimum charge of the express company and could have been several times as large without exceeding this minimum. It was expected that, since the new line would sell much faster than the old line, dealers would order in considerably larger quantities, and that fewer shipments subject to the minimum charge would be made.	Approximately 1½ cents
Display........	A large part of the costs of display had been the expense of design. Since these costs would be distributed over a much larger volume, they could be reduced substantially per pound.	1 cent
Bad Debts and Returns.	The slowness of stock-turn of the expensive packages had led to much spoilage of inventories on the dealers' shelves and also to slow payment. The company's receivables outstanding had, on the average, been equivalent to 90 days' business. It was expected that higher stock-turn not only would reduce spoilage but also would induce prompt payment by the dealers, who would be anxious to insure delivery of their repeat orders.	Approximately 0 cents
Overhead......	It was proposed that all newspaper and magazine advertising be eliminated and that the company rely, for dealer cooperation in pushing sales, on the stamping of the particular dealer's name on the boxes. It was proposed to maintain the administrative force, including the president, treasurer, sales manager, and accountant, as before. It would probably be necessary to add several clerks to handle the greater number of orders and shipments expected and to attend to the billings and collections. It was estimated that the total cost of administration would rise somewhat, but that the increase would be more than offset by the saving in advertising.	Total cost approximately $90,000*

* Reduction from a figure of roughly $114,500.

The president presented his plan and the results of his test campaign to the board of directors in December, 1932. He declared before the board that in his opinion it was entirely possible for the company to obtain a volume of 1,500,000 pounds within a year, and to produce this candy for sale at a profit, by reducing the retail price from $1.50 to 50 cents per pound. He pointed out that the company, in spite of continued deficits, still possessed ample liquid funds to finance operations on the scale contemplated in the new plan, and requested that the funds be used for that purpose. He argued further that it would be entirely possible for the Gobelin company to attain the necessary volume because it would have no real competition. He was certain that the quality of the new 50-cent chocolates was well above that of any chocolates on the market which retailed under $1 a pound, and he was convinced that no competitor would be willing to take the drastic steps necessary to match the Gobelin company's offer. He pointed out that, even if, later on, some competitors did copy the Gobelin plan, it would be too late for them to displace the Gobelin company, which would have established a place for itself in the candy market.

One of the directors was extremely skeptical of the president's statement that sales of 5,000 pounds per day could be obtained, and asked the president if the company had ever succeeded in selling as much as 5,000 pounds in one week. The president replied that it had been done on a limited number of occasions in the past but had not been done consistently for several years.

Should the president's recommendation have been adopted?

3. COLUMBIA RECORDING CORPORATION

REDUCTION IN THE PRICE OF PHONOGRAPH RECORDS

On August 6, 1940, the Columbia Recording Corporation announced price reductions on all its Blue Label phonograph records. Columbia Blue Label records, which consisted principally of classical music, formerly had been sold at retail prices of $1 and $1.50 for the 10-inch size and $1.50 and $2 for the 12-inch size. These prices were reduced to 75 cents for the small records and $1 for the larger ones. The price cut was neither temporary nor impulsive but was

the result of careful planning, dating back to December, 1938, when the Columbia Broadcasting System had purchased the American Record Company and changed its name to the Columbia Recording Corporation.

Many of the reasons for this purchase were intimately interrelated with the history of the record industry. Sound was successfully recorded as early as 1857, but the first well-known instrument was developed by Thomas A. Edison in 1877. Before 1900, phonographs and phonograph records had been placed on the market; in 1901 the Victor Talking Machine Company was founded and soon became the leader in the field. Record sales increased steadily, with the Victor company always in the lead, but with Columbia, Edison, and a few other makes of records enjoying wide popularity. The peak of record sales was reached in 1921, when sales of the industry as a whole were estimated to be 125,000,000 records. Sales declined in the years immediately following 1921; but by 1929 they had again improved, and reached about 100,000,000 records in that year. Contrary to popular belief, the competition of radio did not seriously affect record sales before 1929. After 1929, however, the competition of radio, together with the business depression, greatly reduced sales. Of the 10,000,000 records which it was estimated were sold in 1932, a rough approximation gave the Victor company (then controlled by the Radio Corporation of America) 3,000,000; the American Record Company, which was selling through chain stores, 6,000,000; and the Columbia company less than 1,000,000. Despite many predictions that the industry was doomed, it staged a remarkable comeback; and by 1938, record sales were estimated at 30,000,000, with Victor once again in the lead, although a newcomer, Decca Records, Inc., was close behind. The Decca company, founded in 1934, embarked upon the manufacture and sale of phonograph records of popular music at 35 cents. Most of Victor's popular records had been priced at 75 cents. Although Victor sold the Bluebird records of popular music at 35 cents, it reserved most of its better artists for its 75-cent records. Other companies had tried low prices; but Decca had an advantage not enjoyed by previous ventures into this field, since the quality of its records was high and its recording artists were among the most popular. Estimates of Decca sales were 2,000,000 records in 1935, 5,000,000 in 1936, 8,500,000 in 1937, and 12,000,000 in 1938. Thus, by 1938, the record industry, far from being dead, was

Exhibit 1
Value of Products for the Musical Instruments, Radio, and Phonograph Industries for Selected Years, 1904–1939
(Millions of Dollars)

	1904	1909	1914	1919	1921	1923	1925	1927	1929	1931	1933	1935	1937	1939
Musical Instruments Industries:														
Pianos	47	67	63	107	74	111	101	75	43	13	7	12	22	20
Organs	6	5	6	6	10	10	12	15	11	5	2	2	5	3
Piano and Organ Materials[a]	13	18	20	37	19	39	37	22	12	3	2	3	5	5
Musical Instruments and Parts and Materials Not Elsewhere Classified	3	3	4	13	12	16	20	18	14	8	5	9	12	12
Phonograph Industry—All Products	10	12	27	159	98	107	61	95	97	[b]	[b]	[b]	[b]	[b]
Radio, Radio Tube, and Phonograph Industries—All Products	[b]	[b]	[b]	[b]	[b]	[b]	[b]	[b]	[b]	193	122	201	278	276
Radio and Phonograph Industries—Selected Products:[c]														
Disk Records	5[d]	3	10	43	47	36	27[d]	31[d]	34[d]	8	3[e]	4[e]	5	16
Phonographs	3	5	15	92[f]	39[f]	57[f]	23[f]	49[f]	43[f]	2	2	8	7[g]	22
Radios	[b]	0.4[h]	1[h]	8[h]	10[h]	19[i]	112[i]	114[i]	284[i]	117[j]	71[j]	135[j]	177[j]	161[j]
Radio-phonograph Combinations	[b]	[b]	[b]	[b]	[b]	[b]	[b]	9[g]	22	6	1	2	5	17

[a] Parts sold as parts only. Since many parts were sold to piano and organ manufacturers, the value is duplicated in those classifications.
[b] Data not available.
[c] For the years prior to 1931, figures for disk records, phonographs, and radio-phonograph combinations were found under "Phonographs," and figures for radios under "Electrical Machinery and Supplies." Subsequently, all appeared under the classification "Radios, Radio Tubes, and Phonographs."
[d] Includes some cylinder records.
[e] Includes electrical transcriptions and other records.
[f] Includes radio-phonograph combinations and dictating machines.
[g] Includes dictating machines.
[h] All radio apparatus, including parts, transmitters, and so forth.
[i] Loud speakers and receiving sets only.
[j] Receiving sets of all types, including radio-phonograph combinations.
Source: U.S. Bureau of the Census, *Biennial Census of Manufactures* (Washington, Government Printing Office).

enjoying a healthy revival. A summary of figures compiled from the Census of Manufactures, showing the value of the products of the phonograph, radio, and musical instrument industries, is given in Exhibit 1.

In November, 1938, as a promotion scheme, a New York newspaper offered classical albums to its readers at prices averaging about 49 cents per record. At a time when the record companies considered that the average sales of a classical album should be about 6,000 sets, and a sales volume of 10,000 sets, even over a period of two years, was extremely unusual, the newspaper sold more than 50,000 sets of a single symphony in a few weeks. There was a belief that the people of the United States had come to appreciate music of all kinds more than previously because the radio had accustomed them to hearing music every day. In the classical field, particularly, increased popularity was noticeable especially from the enthusiastic reception of the broadcasts of symphonic and operatic performances.

Observing these facts, the executives of the Columbia Broadcasting System concluded that there was an excellent opportunity to expand the market for phonograph records by a soundly conceived price policy. Accordingly, arrangements were completed whereby the Columbia Broadcasting System, in December, 1938, purchased from Consolidated Film Industries the American Record Company, which in the meantime had gained control of the Columbia name for records, as well as the Vocalian, Okeh, and Brunswick labels. The name of the company was changed to the Columbia Recording Corporation; and Mr. Edward Wallerstein, long connected with the record industry, became its first president. He immediately devoted his attention to the development of a plan for attaining a larger volume of sales at lower prices.

When the new company began the year 1939, current conditions were roughly as follows: Record sales by the entire industry for 1938 were estimated at about 32,000,000, of which Victor had 13,000,000, Decca 12,000,000, and the American Record Company 6,500,000. Of Victor's sales, about 3,000,000 were classical records and 10,000,000 popular; Decca's sales were almost entirely popular; and less than 300,000 of the sales by the American Record Company were in the classical field. The retail price structure for the most important records was approximately as follows:

Classical Records	
Victor Red Seal	\$1.75–\$2.00
Columbia Blue Label	1.00– 1.50
Decca	0.75– 1.00
Semiclassical and Well-established Popular Records	
Victor Black Seal	\$0.75
Brunswick	0.75
Columbia	0.75
Popular Records	
Victor Bluebird	\$0.35
Decca	0.35
Vocalian	0.35

Sales of 10,000 for a single 75-cent record were considered good, but sales of 25,000 were not unusual. About 25,000 of an average 35-cent record could be sold; yet poor records might attain sales of fewer than 2,000; and records made even by well-known artists ranged from 12,000 for poorly received compositions to 100,000 for a highly popular work. Among classical records, a sale of 5,000 sets was considered good, while some sets might achieve sales of only 200, and extremely popular releases might reach 50,000. Most sales of a popular record were made within six months of its release, but the sale of classical sets frequently extended over three or more years.

Since the volume of records sold by the American Record Company just before it was taken over by the Columbia Broadcasting System was relatively small, and since its records did not then enjoy the same acceptance as Decca's and Victor's, the first task undertaken by the new management was to improve the reputation of Columbia records. Obviously, the appeal of a record depended on two factors: (1) its physical qualities, that is, how well the recording was done and how accurately the recorded sounds were reproduced when the records were played, and (2) the selection recorded, that is, the musical composition itself, its interpretation, and the skill and reputation of the musicians.

The Columbia Recording Corporation attacked both these problems simultaneously. First, it substituted a large Banbury mixer for the many small mixers previously used and thereby produced more uniform record material. In this respect, the company was only attaining the uniform quality already present in the best records available from other companies. In the meantime it was refining a process of using laminated records, which originally had been developed by one of its predecessor companies, the

Columbia Phonograph Corporation. By August, 1940, the Columbia Recording Corporation was producing records which it claimed surpassed competing records in quality; the chief advantage of its records was a marked reduction in surface noise. With respect to the quality of the music itself, new artists and musical organizations were engaged to record for Columbia; and a large number of recordings originally made in Europe were imported and sold under the Columbia label.[1]

During the first year of operation of the Columbia Recording Corporation, the records pressed from imported recordings were sold at the old prices of $1 to $1.50, while new recordings of classical works made by American artists and orchestras recently added to Columbia's group were sold at $1.50 and $2, the same prices as those obtained for Victor Red Seal records. By the middle of 1940, Columbia had succeeded in building up an impressive list of artists and organizations who recorded exclusively for Columbia. These included, for instance, the New York Philharmonic Symphony orchestra with such conductors as John Barbirolli and Igor Stravinsky; Leopold Stokowski, conducting the All-American Youth Orchestra; the Chicago, Minneapolis, and Pittsburgh symphony orchestras; Andre Kostelanetz; Gregor Piatigorsky; and others. The company's advertising proclaimed that the "greatest music and the greatest artists" could be heard on Columbia records. Thus, by early 1940, Mr. Wallerstein believed that Columbia records had attained an excellence, both in mechanical perfection and in musical quality, which made them definitely superior to the products available from competitors.

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[1] Briefly, the process of making a record to be sold to the public was as follows: An orchestra, for example, played before a microphone, which changed the sound waves into electrical vibrations. These electrical vibrations activated a stylus, which recorded them on a wax disk. From this wax disk a more permanent copper "master" was prepared by electrolysis. By subsequent electrolytic processes a nickel "mother" and a chrome "matrix," sometimes called a "stamper," were prepared. The stampers were used directly in the production of the finished records; and as they wore out, they were replaced with new ones made from the mother.

The records which were sold to the public were pressed in a machine resembling a waffle iron; a plastic biscuit was placed between two stampers, whose recorded vibrations were transferred to the plastic material. The pressers were first heated with steam to make the plastic pliable and then cooled with water to harden it. Subsequent trimming and polishing completed the record, except for inspection and packaging.

Because of the nature of the process, making finished records was known in the trade as "pressing." The European recordings sold by Columbia were pressed in the United States, the nickel mothers only being imported.

Concurrently with the problem of building up Columbia's public acceptance, the new management faced many other problems. On January 1, 1939, for instance, Columbia had approximately 1,200 dealers in the United States and possessed a very ineffectual wholesaling organization. Along with its efforts to improve the quality of its records, therefore, the company had to rebuild a distributing organization. Plant rehabilitation was likewise required, as was the bolstering of morale within the company. While these problems were important and had a definite bearing upon the timing of a price reduction, the methods used in solving them need not be recounted in order to understand the company's price policy.

In addition to perceiving that the record industry might be a fertile field for more intelligent pricing, the management of the new Columbia Recording Corporation had the more specific problem of determining the extent to which prices should and could be reduced. Mr. Wallerstein, while observing the general trends in the industry, had sought to test more specifically the public's reaction to lower prices. In a controlled experiment, he had persuaded several dealers to keep accurate records of their regular sales and then, for one month, to offer to all customers who entered their shops regular semiclassical records at two-thirds of the list price. It was found that such an unannounced price reduction of 33⅓% had more than doubled the unit volume of sales made by those dealers. This concrete evidence, in addition to the observed trends, convinced Mr. Wallerstein that substantial price reductions in classical records would increase volume enormously.[1]

The next step was to examine the effect of the price cut on the company's revenue and the effect of increased volume on the cost of making records. During the first six months of 1940, the average list price of 10- and 12-inch Columbia Blue Label records was $1.44; and the average net revenue received by the company was 59 cents. Mr. Wallerstein estimated that reductions in price to $1 and 75 cents would cut the average list price to 95 cents and the company's average net revenue to 41 cents. An analysis of the

[1] At this point the management devoted its attention to classical records, because the price of popular records was already low and the popular field had been well exploited by the Decca Company. Furthermore, the classical field presented more opportunities for new pricing strategy. Meanwhile, however, the Columbia Recording Corporation, as part of its general rehabilitation program, revived the Okeh label for popular records, engaged new popular artists and bands, and actively promoted that aspect of the business.

cost of making Blue Label records at the volume of production attained during the first six months of 1941 is given in Exhibit 2.

In order to get a first approximation of cost under conditions of higher volume, Mr. Wallerstein examined each of the costs and estimated the changes that would occur if volume increased. He based his calculations on two estimates: (1) He assumed that volume would double if prices were reduced as proposed. He chose this as the practical minimum increase that would make a price change worth while. (2) He assumed that, as an upper limit,

Exhibit 2
Columbia Recording Corporation
Analysis of Costs of Blue Label Records,
First Six Months of 1940*

	Cost as a Percentage of Total Cost
Pressing	16.9%
Matrix	4.2
Artists	11.8
Artists' Royalties	8.3
Copyright	1.2
Recording	5.1
Album	11.8
General Administrative and Selling	40.7
Total Cost	100.0%

* The analysis is given in percentages in order to avoid revealing the company's actual costs. The proportions, however, are substantially accurate.

volume might increase to the total capacity of the company's plant, working 24 hours a day in three shifts.

Brief descriptions of each of the costs and Mr. Wallerstein's appraisal of it are given below.

Pressing. The pressing operation was the one in which the records were made from the matrices in the pressers. There were some overhead charges for the equipment, space, and so forth; but the largest items of cost were labor and material. Mr. Wallerstein expected that the cost of pressing each record would decline slightly if volume doubled but that it would be approximately equal to the current costs if capacity production were attained. The reason for the negligible saving resulting from greatly increased volume lay in the fact that reductions in overhead cost would be offset to a large extent by decreasing efficiency in three-shift production. Although commodity prices were rising, the company had on hand a sufficient quantity of raw material to prevent any substantial

increase in its material costs for about three years. In other words, Mr. Wallerstein was certain that the cost of pressing per unit would not increase; but he was not willing to predict any substantial decline.

Matrix. This operation included all the steps of preparing the pressers from the original wax recording; the cost within the volume ranges under consideration was practically fixed in total.

Artists. This cost represented the fees paid to the musicians who played for the recording. Theoretically the fees were fixed, regardless of the number of records sold, inasmuch as the artists were paid a flat recording fee. Actually, however, Mr. Wallerstein found it difficult to predict the behavior of this cost, because the fees were established by bargaining between the company and the musicians. If the company's plan to increase sales was only moderately successful, little change might be expected in the recording fees. If sales increased tremendously, however, the musicians' union would probably demand higher recording fees. Temporarily, at least, the cost per record was expected to decrease in direct proportion to volume increases.

Artists' royalties, in addition to the musicians' fees, consisted of payments to certain soloists, conductors, and so on. The royalties were established as a percentage of retail price and hence would be reduced per record in proportion to the decrease in price. The company was not required to pay artists' royalties on some of its imported records; but since new American artists were being added to the group, royalties in the future would have to be paid on a larger percentage of the records. Estimates indicated that the average royalty per record for all Blue Label records would be reduced from current levels by about 40% if volume doubled and by 20% at capacity volume.

Copyright. Copyright payments were fixed per record.

Recording. Recording costs included not only the expense of making the master wax recording but also the cost of managing artists. These expenses were expected to remain fixed in total, regardless of volume.

Album. The cost of the album was a special case. It had been the custom of the industry to give an album free with all sets of records which sold for $6 or more at retail and to charge 50 cents for each album with a set of records which sold for less than $6. Since most albums included at least three records selling

for $2 each, a great majority of albums were given free. The contemplated reduction in the price of records would result in a retail price of less than $6 for many sets and thus provide additional revenue from the sale of albums. The management expected that this factor, in conjunction with a redesigning of the album to permit manufacturing economies, would eliminate the album from consideration by making the revenue equal to the cost.

Selling and Administrative Expense. Selling and administrative expenses were charged to all records, classical and popular, equally on the basis of the number sold. No change was expected in the popular end of the company's business; consequently all the increased cost of selling and administration was to be charged to the Blue Label records. Mr. Wallerstein estimated that, if volume doubled, the increased selling and administrative expense would amount to 5% of the cost currently charged to Blue Label records and that, if three-shift capacity were reached, the increase would amount to 10% of the cost currently charged to Blue Label records.[1]

After the Columbia Broadcasting System had taken over the recording business, the belief that good records could be sold in large volume at lower prices was further strengthened by the success of the National Committee for Music Appreciation, which advertised itself ostensibly as a nonprofit organization devoted to the task of bringing symphonic music to a large number of people. This committee offered a series of 12 symphonies at prices ranging from $1.39 to $3.03 per set, in comparison with corresponding prices of $6.50 and $10.50 for products of the major companies. Although the records offered did not show the names of the orchestras or the conductors, and although the records could not be played before purchase, this organization achieved a large volume of sales.

By June, 1940, Mr. Wallerstein was satisfied that, from a competitive point of view, the price could safely be cut without causing the reaction that Columbia was just another record company putting out second-rate music on poor-quality records. Accord-

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[1] In order that the student may follow the company's reasoning in concrete terms, the Columbia Recording Corporation has authorized the use of some hypothetical figures, which are purely illustrative and do not reveal the company's actual operations. Thus, for purposes of illustration, it may be assumed in interpreting Exhibit 2 that the company's sales of Blue Label records during the first six months of 1940 were at an annual rate of 780,000, that annual capacity for producing Blue Label records was approximately 3,500,000 records, and that the total cost per Blue Label record during that time approximated the average net revenue from Blue Label records.

ingly, all plans were worked out to put the price reduction into effect as soon as the time was favorable. The sale of phonograph records was known to be seasonally low in the summer months, with revival coming early in the fall. Consequently, the ideal time for a price reduction was thought to be immediately after Labor Day. In the latter part of July, 1940, however, the Victor company began a promotion offering its dealers an inventory protection plan designed to encourage them to stock more records than they would otherwise do. In order to give the dealers an incentive to buy records, the Victor company was offering a return privilege in excess of that normally granted after a certain period of time had passed.

Because the executives of the Columbia Recording Corporation believed that its dealers, as well as Victor dealers, might add to their stocks, they decided to introduce the new low prices immediately in order to avoid losses on inventories in the hands of dealers. Consequently, the Columbia salesforce was called into the head office, the plans announced, and instructions given. The move, which surprised even the Columbia organization, received its first public announcement on August 6, 1940. The Victor company made similar price reductions on its Red Seal records three days later.

Did the Columbia Recording Corporation follow a sound price policy?

4. DEWEY & ALMY CHEMICAL COMPANY (A)

PRICING A NEW PRODUCT

The Dewey & Almy Chemical Company in 1930 perfected in its laboratories a new type of sole for shoes, and gave it the trade name "Darex." This product was composed of compressed felt, impregnated with latex. On completion of the laboratory tests, it was subjected to thorough tests under conditions of actual use. The results of these trials convinced the company that the new product had many competitive advantages. It was of exceptionally light weight; it was slipproof, even on ice; it was waterproof, retaining its nonspreading, nonmarking, pliable, resilient, and crackproof

characteristics when wet; its insulating properties were high, insuring a maximum of foot comfort in extreme temperatures; and in wearing qualities it was at least equal to the finest grade of oak leather. These soles were thought to be particularly advantageous for use in sport shoes, including both shoes for active participation in sports and also the so-called spectator sports fashions. It was also thought that a market could be developed for Darex soles on both men's and women's shoes for ordinary street wear.

The new product would be sold in competition with leather, crepe rubber, and composition soles. Highest-grade leather shoe bottoms, including both soles and heels, ordinarily were sold to shoe manufacturers at about 75 cents a pair. Rubber and composition shoe bottoms were sold at 25 cents to 55 cents a pair. Rubber heels alone were sold at 4 cents to 8 cents a pair.

Manufacturing costs on an initial output of 10,000 pairs of Darex shoe bottoms amounted to 54 cents a pair, but the officers estimated that this figure could be reduced to 49 cents a pair for production in larger quantities. These costs included a fair average price for raw materials and also factory overhead and labor expense but did not include research, administration, sales, or advertising expense. Raw materials accounted for 80% of manufacturing costs. For purposes of estimating, rubber, the principal raw material, was figured at 15 cents a pound, the average market price over a period of several years, though actually at this time the market price was below this figure.

The officers of the company hoped to make the product as nearly self-supporting as possible during the introductory stage. The sales manager submitted a marketing budget for Darex shoe bottoms in 1931 of $70,000, with the suggestion that this appropriation be increased if gross profits exceeded $70,000. In this figure were included salesmen's salaries and traveling costs at $29,000, samples at $3,000, and advertising at $36,000. The executives considered that, after the product was established, the marketing expense should not exceed 20% of sales. They thought that eventually the company should have a gross margin of 35% of sales to cover selling, administrative, advertising, and research expenses and net profit. The president suggested that the proposed initial marketing budget of $70,000 was possibly too high.

As many as 50 new brands of shoe soles often were introduced to the trade in a year; hence in order to prevent Darex from being

considered just another sole, the company planned to emphasize the quality and distinctiveness of the product rather than price. In view of the quality appeal, it was probable that introductory sales efforts would be confined to manufacturers of shoes selling at retail for $10 or more a pair. Many shoes, particularly in the higher price ranges, were sold by manufacturers direct to retailers. Retailers' markups usually ranged from 33⅓% to 40% of retail. According to company estimates, a manufacturer of high-grade shoes was willing to spend for shoe bottoms an amount approximately equal to 10% of his net selling price for the shoes. In shoes in which cheaper leathers or other materials were used for the uppers, the proportionate cost for the bottoms could be slightly increased.

According to the census figures released on December 31, 1930, the total number of pairs of boots and shoes manufactured in the United States in 1929 had been 324,617,284. This figure did not include rubber footwear. Estimates varied as to the relative output of shoes retailing at prices of $10 or more. It was unlikely that such shoes represented more than 5% of the total production, and it was possible that the proportion was as low as 2½%. The volume of sales of men's and women's shoes at retail prices between $7 and $10 was thought to be from five to ten times as great as the volume of sales at $10 or more.

What price should the Dewey & Almy Chemical Company have established for Darex shoe bottoms?

5. DEERFIELD COMPANY

PRICING A NEW PRODUCT

The Deerfield Company was organized in 1937 to manufacture and market "Weldit," a newly invented adhesive cement. The formula had been developed by a foreign chemical concern, and the Deerfield Company had purchased the American rights for $10,000 plus a royalty of 8 cents a pound.

As the result of the sale of some stock, the company began business with $18,500 in cash. Of this amount, $3,500 was paid immediately as part of the purchase price of the American rights. The remainder of the purchase price was paid in the company's serial notes.

Weldit had special characteristics superior to those of other cements and glues on the market. It did not crack when dry and was not affected by moisture or temperature. Because Weldit could be cut, even when completely dry, it could be used as a filler on shaped surfaces; and any excess cement which would mar the appearance of a joint could be removed. Since it was transparent and would hold a surface of paint, it could be used with materials of any color. The product was effective in cementing china, glass, paper, and wood; and it could be used on rubber, although inferior to rubber cement for this purpose.

Mr. Deerfield had registered the trade-mark "Weldit" and had applied for a patent on the product itself. Certain narrow formula claims had been allowed by the Patent Office, but the application covering the three basic ingredients was still subject to adjudication. Mr. Deerfield and his associates, however, had gone ahead with production and marketing plans.

The company found a factory building suitable for the manufacture of the cement in a suburb of Philadelphia, where an adequate supply of labor was available. The building had been vacant for some time, and its owner accepted a rental of $1,350 for a period of two years and three months, which was paid in advance.

In addition to Mr. Deerfield, who was the president, Mr. Anderson, the production manager, and Mr. Barry, the sales manager, were the active officers of the company. Mr. Barry, a man in his early thirties, had given up his position as a salesman for a Philadelphia hardware wholesaler to devote all his time to the Deerfield Company. The three executives had offices at the factory and consulted one another continuously and informally on all matters of general interest to the concern. All shared, therefore, in the discussion of important marketing problems. The three, for instance, had decided that a 4-ounce container was the best size for selling Weldit in the consumer market.

The company's management decided at first to sell Weldit to hardware wholesalers and through them to hardware retailers. A company policy was established of granting no exclusive agencies; sales were to be made to as many wholesalers as possible. Mr. Deerfield knew that many consumers bought glue and mending cements from retail drug stores and variety chains, however, and he believed that serious consideration should be given to the advisability of using these outlets. He agreed to postpone consideration

of this problem pending the outcome of a sales campaign in the Philadelphia area with distribution through hardware stores.

The company's officers believed that missionary sales work, direct-mail advertising to the trade, dealer helps, and some type of consumer advertising would be necessary in order to establish the product in the market. Because the company's plant was located in Philadelphia and because Mr. Barry was familiar with the situation in the hardware field in this area, Mr. Deerfield suggested that initial distribution and promotional efforts be confined to the Philadelphia area, in order to minimize expenses. In his judgment this experience would be valuable in making plans for the distribution of Weldit in other sections of the country.

Mr. Deerfield and Mr. Barry planned to devote much of their time to active sales work, principally with wholesalers. They believed that it would be necessary to employ missionary salesmen to call on retailers. Such salesmen could be hired for $30 to $40 a week plus traveling expenses, which were estimated at about $10 a week.

Mr. Deerfield and his associates proceeded to gather information which they believed would be of value in formulating marketing plans in Philadelphia. They noted from a survey of the Philadelphia marketing area that the population of the metropolitan area was 3,320,000 people and of the Philadelphia trading area, 6,753,000 people. This latter district included territory adjoining Philadelphia in both Pennsylvania and New Jersey and roughly comprised the Third Federal Reserve District. From the same source they learned that there were 875 retail hardware stores in the metropolitan area and 1,695 in the trading area. There were 62 hardware wholesalers in the trading area, of whom 29 were located in Philadelphia. Most of the wholesalers confined their operations to the trading area or some part of it, although a few sold outside this territory. Local wholesalers in small cities outside Philadelphia limited their operations to radii of 10 to 15 miles from their warehouses.

The officers of the Deerfield Company believed that an effective consumer advertising campaign would be desirable in launching the product. They agreed, however, that point-of-purchase display was the only "must" type of consumer advertising and that space advertising in newspapers and car cards should be undertaken only if finances permitted. Simple yet effective counter display

easels, in lots of 1,000 or more, could be purchased at 60 cents each. A small leaflet to place with dealers could be obtained at a rate of $100 for lots of 10,000. The advertising agency consulted stated that space campaigns used for launching products varied widely in accordance with the potential market for the products, the effectiveness of advertising in selling the product, and the amounts that firms were willing to risk in a marketing venture. It cited from its own experience instances of introductory campaigns in the Philadelphia area in which newspaper space advertising over the first year cost a few hundred dollars, and other instances in which the outlay exceeded $10,000. Car card advertising for the lines operating in the metropolitan area had a rate for full service, that is, one card for each car operating, of $1,900 a month; or for half service, one card in every other car, of $1,045 a month.

Exhibit 1
Deerfield Company
Estimated Factory Cost of One 4-Ounce Unit of Weldit

Raw Materials	2.5¢
Cases, Cartons, Jars	2.2
Factory Labor	1.0
Royalty	2.0
Inward Freight	0.2
Insurance	0.1
Rent	0.2
Depreciation of Machinery	0.1
Miscellaneous	0.3
Total	8.6¢

Complete and precise estimates of selling and administrative expenses could not be made, because of the uncertainties attaching to the new venture. The three executives had agreed to draw no salaries from the business until after the first year, or until the business became profitable. Office expense, including clerical work, supplies, taxes, and general expenses, was estimated at $5,000 a year.

An estimate of manufacturing costs was prepared with considerable confidence. At a production rate of 300,000 four-ounce units a year, the factory cost per unit was estimated to be 8.6 cents, as shown in detail in Exhibit 1. At a production rate of 1,500,000 units a year, the estimated factory cost per unit was 6.6 cents.

The officers found it difficult to estimate the potential demand for Weldit as a basis for pricing. Most of the products competitive with Weldit were single-purpose products such as glass cement

and rubber cement. The product most nearly like Weldit was ordinary glue.

Popular brands of cements on sale at hardware stores carried the retail prices shown in the following table.

Product	Size of Package (ounces)	Retail Price (cents)	Retailer's Margin (% of retail price)
Mucilage:			
Brand A	1 oz.	10¢	50%*
Household Cement:			
Brand A	1½	25	33⅓†
Brand B	1½	25	33⅓†
Brand C	4	50	33⅓†
Rubber Cement:			
Brand A	2	25	40*
Brand B	¾	10	40*
Liquid Glue:			
Brand A	1½	10	40*
Brand A	4	25	40*
Brand A	8	40	40*
Brand A	16	70	40*

* Purchased by retailers direct from manufacturers.
† Purchased by retailers from wholesalers.

Mr. Barry knew from his experience in the hardware business that the average gross margin realized by hardware wholesalers was about 22%.

Although Weldit was superior to glue in some uses, the company officials believed that sales resistance might be caused by established confidence in glue and single-purpose cements. If, however, consumers came to recognize the superiority of Weldit for specific uses and its suitability for many uses, the product would become, in large measure, a noncompetitive specialty.

At what price should the Deerfield Company have sold Weldit to wholesalers?

6. HODNUTT COMPANY

RELATION OF MANUFACTURERS' EXCISE TAX TO RETAIL PRICE

In October, 1941, the executive officers of the Hodnutt Company, a department store in a large midwestern city, encountered a pricing problem in connection with the manufacturers' excise tax which became effective as of October 1.

The particular section of the Revenue Act of 1941 read as follows:

> There shall be imposed on the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):
>
> Radios, phonographs, phonograph records, musical instruments, refrigerators, refrigerating apparatus and air conditioners, sporting goods, luggage, electric, gas and oil appliances, photographic apparatus and equipment, electric signs, business and store machines, rubber articles (with exception of footwear and surgical articles), washing machines for commercial use, optical equipment, electric light bulbs and tubes.
>
> All the above classifications of merchandise and all items within the classifications will be subject to a 10% tax.

In the Hodnutt Company 10 departments, contributing 8% of the total store volume, would be affected. Mr. Carter, the buyer for the luggage department, stated that the new taxes would necessitate a change in his price line structure. To illustrate his point, he presented the following example to the management:

> A piece of luggage which at present costs the store $12 and has a 40% markup on retail now sells for $20. Under the new tax the same piece of luggage will cost $13.20 and will have to sell at $22 if the store is to make its 40% markup. Such increased prices are going to set up a certain degree of sales resistance and hence tend to increase departmental expenses. This resistance can be avoided by substituting cheaper quality and retaining original prices.

The management of the store did not have quite the same opinion as Mr. Carter. It believed that, in view of the increased salaries which families were receiving and the generally better times, people would pay the higher prices without much hesitation. Furthermore, one of the executives of the company argued that, in view of higher future taxes by the government and the curtail-

ment of retail sales volume which was bound to follow the emergency, larger markups should be taken on all merchandise whenever possible. Because of this reasoning, the management initially instructed the buyers to consider the tax as simply part of the cost of merchandise and take their markups in the regular way.

The publicity given to two telegrams received by the National Retail Dry Goods Association, however, one from Leon Henderson, Administrator of the OPA, and the other from Fred Lazarus, Jr., Chairman of the Retailers' Advisory Committee of the National Retail Dry Goods Association, caused the executives of the Hodnutt Company to suspend their initial instructions to buyers until the pros and cons of the problem could be weighed more carefully. These telegrams were as follows:

Telegram from Leon Henderson:

We request that there be no pyramiding of the federal manufacturers' excise tax. The increased prices paid by consumers as a result of new levies should in no case reflect more than the actual dollar amount of total excise tax. This policy should apply where excise taxes are being continued and increased as well as where taxes are now being levied for the first time.

LEON HENDERSON, ADMINISTRATOR,
Office of Price Administration

Telegram from Fred Lazarus, Jr.:

The Office of Price Administration has requested the cooperation of retailers all over the United States in preventing the application of retail margins to the manufacturers' excise tax levied on consumer goods, effective October 1. Our committee feels it is expressing the opinion of all retailers and of your trade association in stating that it considers it imperative that no margins should be charged on taxes levied at the manufacturing level. The Office of Price Administration asked us to request you to bulletin your membership. Kindly advise us by wire of the action you are taking and send us a copy of your bulletin. We will appreciate your cooperation.

FRED LAZARUS, JR., CHAIRMAN,
Retailers' Advisory Committee

The National Retail Dry Goods Association sent the following telegrams in reply to Messrs. Henderson and Lazarus:

Telegram to Leon Henderson:

In reply to your telegram we are anxious to cooperate with you in every way possible but your proposal has many implications which we

believe we should have full opportunity to discuss with you before any decision is reached. We will hold ourselves in readiness to call upon you with a small delegation at any time you care to appoint. The question is too important for any decision by me without consulting membership.

LEW HAHN, GENERAL MANAGER, NRDGA

Telegram to Fred Lazarus, Jr.:

The subject of your telegram is so important and revolutionary to all previous conceptions that we feel this point should not be decided without fullest opportunity for conference with you and Leon Henderson who has just wired me on same subject. Those retail men with whom I have thus far discussed the matter are not at all in agreement with you. They feel as the Treasury Department apparently does that these taxes represent a new item of cost and should be treated as any other cost. The manufacturers' excise tax will represent additional retail expense as payment of commissions to salespeople and in connection with rental paid on a basis of sales. Also, to charge only the amount of the tax will create difficult price line situation and reveal clearly the retailer's cost. I am submitting question today to important meeting of Vendor Relations Committee for their reaction and will consult Board and other important factors. We would greatly appreciate deferment for a week or so of necessity of final decision. We are anxious to cooperate but believe question requires complete airing.

LEW HAHN, GENERAL MANAGER, NRDGA

As a result of these telegrams, a meeting was arranged with members of Mr. Henderson's staff. Before the NRDGA delegation left to confer with Mr. Henderson, the telegrams were read to the Vendor Relations Committee, consisting of 35 or 40 retailers; and all but two disapproved of the Henderson and Lazarus suggestion. The two who took a different attitude seemed to think it might be possible to accede to Mr. Henderson's request by not putting any markups on the taxes but by increasing the markup percentages on the merchandise itself to compensate for the loss.

The arguments advanced by the NRDGA delegation at its meeting with members of Mr. Henderson's staff were as follows:[1]

(1) The manufacturers' excise tax will appear on the purchase of goods from manufacturers as an additional item of retail cost. It should be treated as any other increase in cost and be subject to the stores' retail markup.

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[1] See National Retail Dry Goods Association, Special Bulletin to Members, No. 105, October 10, 1941.

(2) If this is not done, it will reduce the percentage of markup. For example, assuming that a certain article has carried a 40% markup at retail, it will work out as follows:

Cost	$ 6.00	Cost	$ 6.60
Markup	4.00 (40%)	Markup	4.00 (37.7%)
Retail	$10.00	Retail	$10.60

(3) It should be remembered that even upon the present basis there are many stores which seldom, if ever, earn a net profit of much over 3%. Thus, on the articles affected by these taxes, most of the net profit will be absorbed by the Henderson proposal.

(4) Congress enacted these taxes with apparently a definite intention that they would constitute an additional item of cost and that they would be passed on in the usual way to the consumer. If Congress had not so intended, it could have placed these taxes at the retail level, as it has done with furs, jewelry, and cosmetics. The Treasury Department recently has indicated these taxes should be regarded as any other item of increased cost.

(5) It should be pointed out that the same causes which are increasing manufacturers' operating costs are also increasing retail costs. The retailer is paying more for everything with the possible exception of rent, and where leases are renewable during this period, rents also may be expected to rise. All supplies have mounted rapidly in cost. Labor costs are constantly on the increase and working hours are being sharply reduced. In industrial sections especially, retail stores are feeling the competition with defense industries.

(6) Retailers are paying higher prices for merchandise which in many instances they cannot recoup by increasing prices. In many instances, manufacturers are exacting a premium for the delivery of orders which they accepted at lower prices.

(7) Manufacturers are reducing or eliminating the customary trade discounts. These discounts in former times have often meant the difference between net profit and loss at the end of the year.

(8) This tax increases the cost of the retailer's goods by 10%. This means, if he is to maintain his inventory at a point which will enable him to serve his trade as formerly, he must invest 10% more capital. Some stores may find this difficult to do.

(9) Where selling employees are paid on a percentage basis, the increase in retail price, through the payment of the manufacturers' tax, will inflate the retailer's payroll. If no markup on the tax is permitted, such increase in payroll will be a dead loss.

(10) Many stores pay rent on the basis of a percentage of sales. This will operate to increase rent payments, without corresponding increase of income.[1]

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[1] Operators of leased departments in the Hodnutt store, who paid rent on a percentage-of-sales basis, had refused to allow the tax figure to be included in the sales figure when computing their rent.

(11) It is to be expected that credit restrictions, priorities, and excise taxes may bring about a decline in units sold as well as in dollar volume.

(12) There is always the chance that if this tax is handled as suggested by Mr. Henderson it will establish a precedent.

One of the executives of the Hodnutt Company had the following point to add to the arguments of the NRDGA: handling of the tax in the manner suggested by Mr. Henderson might reveal store merchandise costs unless the sales price was disguised; for example,

Cost	\$ 6.00	\$0.60	= Tax on Cost
Tax	0.60	0.60	= 10%
Markup	4.00	0.06	= 1%
Retail	\$10.60	6.00	= 100% or Cost

It was the expectation of the management of the Hodnutt Company that Mr. Henderson's contentions in support of his position would be along the following lines:

(1) Pyramiding of the tax will be another step toward inflation with all its evil consequences.

(2) Other types of business enterprise have felt the squeeze of this emergency and have patriotically carried on. It is only right and just that retailers should do likewise.

(3) Retail prices and gross margins in dollars are increasing. Therefore retailers can refrain from taking markups on the tax without diminution in net profit.

In order to check the accuracy of this last point, the comptroller of the Hodnutt Company referred to current monthly data on operations. These figures are presented in Exhibit 1.

What action should the Hodnutt Company have taken?

EXHIBIT 1
HODNUTT COMPANY
Miscellaneous Operating Data, February–September, 1940 and 1941

	February, 1940		February, 1941		Difference
Sales—Entire Store	$348,292		$402,827		$ 54,535
Sales—Owned Retail Departments	319,404	100.0%	370,286	100.0%	50,882
Gross Profit	96,265	30.1	116,467	31.5	20,202
Discounts	16,874	5.3	16,968	4.6	94
Leased Department Profit	7,713	2.4	8,249	2.2	536
Total Gross Margin	120,852	37.8	141,684	38.3	20,832
Expense	160,595	50.3	157,327	42.5	−3,268
Net Profit	39,743*	12.5*	15,643*	4.2*	24,100
	March, 1940		**March, 1941**		**Difference**
Sales—Entire Store	$521,300		$534,434		$ 13,134
Sales—Owned Retail Departments	485,646	100.0%	495,759	100.0%	10,113
Gross Profit	147,697	30.4	155,206	31.3	7,509
Discounts	26,268	5.4	27,067	5.5	799
Leased Department Profit	9,717	2.0	9,399	1.9	−318
Total Gross Margin	183,682	37.8	191,672	38.7	7,990
Expense	181,077	37.3	185,448	37.4	4,371
Net Profit	2,605	0.5	6,224	1.3	3,619
	April, 1940		**April, 1941**		**Difference**
Sales—Entire Store	$604,902		$745,754		$140,852
Sales—Owned Retail Departments	566,759	100.0%	708,897	100.0%	142,138
Gross Profit	177,429	31.3	229,079	32.3	51,650
Discounts	26,196	4.6	29,631	4.2	3,435
Leased Department Profit	9,506	1.7	10,013	1.4	507
Total Gross Margin	213,131	37.6	268,723	37.9	55,592
Expense	192,499	34.0	200,941	28.3	8,442
Net Profit	20,632	3.6	67,782	9.6	47,150
	May, 1940		**May, 1941**		**Difference**
Sales—Entire Store	$611,069		$635,226		$ 24,157
Sales—Owned Retail Departments	572,852	100.0%	600,269	100.0%	27,417
Gross Profit	174,951	30.5	185,970	31.0	11,019
Discounts	27,743	4.8	29,620	4.9	1,877
Leased Department Profit	8,942	1.6	8,938	1.5	−4
Total Gross Margin	211,636	36.9	224,528	37.4	12,892
Expense	195,510	34.1	196,619	32.8	1,109
Net Profit	16,126	2.8	27,909	4.6	11,783

* In red.

EXHIBIT I (*Continued*)

	June, 1940		June, 1941		Difference
Sales—Entire Store......	$566,332		$585,634		$ 19,302
Sales—Owned Retail Departments............	536,345	100.0%	550,923	100.0%	14,578
Gross Profit............	158,928	29.6	165,055	30.0	6,127
Discounts..............	21,408	4.0	23,313	4.2	1,905
Leased Department Profit	9,246	1.7	9,219	1.7	−27
Total Gross Margin......	189,582	35.3	197,587	35.9	8,005
Expense................	183,781	34.2	185,641	33.7	1,860
Net Profit.............	5,801	1.1	11,946	2.2	6,145
	July, 1940		**July, 1941**		**Difference**
Sales—Entire Store......	$397,177		$445,669		$ 48,492
Sales—Owned Retail Departments............	374,370	100.0%	419,465	100.0%	45,095
Gross Profit............	119,829	32.0	152,247	36.3	32,418
Discounts..............	13,291	3.6	17,095	4.0	3,804
Leased Department Profit	5,759	1.5	7,010	1.7	1,251
Total Gross Margin......	138,879	37.1	176,352	42.0	37,473
Expense................	176,575	47.2	179,261	42.7	2,686
Net Profit.............	37,696*	10.1*	2,909*	0.7*	34,787
	August, 1940		**August, 1941**		**Difference**
Sales—Entire Store......	$470,448		$567,753		$ 97,305
Sales—Owned Retail Departments............	442,583	100.0%	532,435	100.0%	89,852
Gross Profit............	135,507	30.6	178,316	33.5	42,809
Discounts..............	18,404	4.2	21,446	4.0	3,042
Leased Department Profit	6,590	1.5	8,124	1.5	1,534
Total Gross Margin......	160,501	36.3	207,886	39.0	47,385
Expense................	176,895	40.0	188,500	35.4	11,605
Net Profit.............	16,394*	3.7*	19,386	3.6	35,780
	September, 1940		**September, 1941**		**Difference**
Sales—Entire Store......	$629,049		$781,218		$152,169
Sales—Owned Retail Departments............	598,654	100.0%	742,561	100.0%	143,907
Gross Profit............	195,412	32.6	253,366	34.1	57,954
Discounts..............	31,085	5.2	34,594	4.7	3,509
Leased Department Profit	8,547	1.4	8,890	1.2	343
Total Gross Margin......	235,044	39.2	296,850	40.0	61,806
Expense................	203,706	34.0	229,813	31.0	26,107
Net Profit.............	31,338	5.2	67,037	9.0	35,699
	Year to Date, 1940		**Year to Date, 1941**		**Difference**
Sales—Entire Store......	$4,148,569		$4,698,515		$549,946
Sales—Owned Retail Departments............	3,896,613	100.0%	4,420,595	100.0%	523,982
Gross Profit............	1,206,018	31.0	1,435,706	32.5	229,688
Discounts..............	181,269	4.6	199,734	4.5	18,465
Leased Department Profit	66,020	1.7	69,842	1.6	3,822
Total Gross Margin......	1,453,307	37.3	1,705,282	38.6	251,975
Expense................	1,470,638	37.7	1,523,550	34.5	52,912
Net Profit.............	17,331*	0.4*	181,732	4.1	199,063

* In red.

X

PRICE POLICIES

1. BOOTHBY COMPANY

TRADE DISCOUNTS

For several years before 1935 the executives of the Boothby Company, a well-established concern manufacturing canvas footwear, rubber boots, rubbers, and other rubber products, had been troubled with the problem of retail price cutting by various customers. To correct this situation, which was general in the canvas and rubber footwear industry, the sales manager in 1934 devised a new plan of trade discounts which he urged the executive committee to adopt.

The company sold its rubber footwear to the following four general classes of customers: Group 1, buyers of very large quantities, such as large chain store companies, mail-order houses, and wholesale concerns; Group 2, regional chain store companies, which competed directly in limited areas with the national chains; Group 3, department stores, large retail shoe stores, and small chains; and Group 4, small retail stores.

In common with other manufacturers of canvas and rubber footwear the Boothby Company had allowed substantial discounts from wholesalers' list prices to chain stores and other large buyers because these buyers purchased large quantities annually and because they performed wholesaling functions. Rubber manufacturers had bid against one another for this business and in the process of bidding had allowed their net prices to drop to low levels. The opportunity to purchase canvas and rubber footwear at low prices thus had afforded the chains and mail-order houses considerable price advantage over the small retail dealers. Since the chains and mail-order companies often were satisfied with a 30% markup on this class of merchandise, and since they frequently used canvas and rubber footwear as price leaders, they sold the merchandise at retail prices which were only slightly above the actual cost of the goods to the smaller retailers.

This retail price situation made it difficult for the small retailers to sell rubber footwear in competition with the chains, and many of the retailers feared that their entire canvas and rubber footwear business would be taken away from them unless they could buy their merchandise from other sources of supply at lower prices. At the time when this fear was developing, however, some of the long-established manufacturers of rubber footwear went into receivership; and consequently they or the later new owners were willing to supply the small retailers with rubber footwear at unusually low prices. The selling prices which these companies quoted to the small retailers were low for the additional reason that the companies either sold through cut-price wholesalers who operated on narrow margins or else sold the merchandise themselves direct by mail to the retailers. These companies were able to take the latter course because of the combination of low prices and well-known brand names which they could offer.

The Boothby Company produced over 1,000 different items of canvas and rubber footwear for men, women, and children. Of the total sales of the company 30% were made directly from the factory to approximately 25 large chains and mail-order companies, and to independent wholesale companies. These organizations (referred to above as Group 1) performed the wholesaling functions of purchasing large quantities of footwear on advance orders, storing the merchandise, and selling or distributing it in small lots. The remaining 70% of the sales were made to regional chain store companies (referred to as Group 2), which competed directly in limited areas with the national chains; to department stores, large retail shoe stores, and small chains (referred to as Group 3); and to small retailers (referred to as Group 4), most of whom purchased only a few hundred dollars' worth of merchandise from the company in a year. Firms in Group 2 performed the same wholesale functions as those in Group 1. Shipments to these firms were made directly from the factory. For retail customers in Groups 3 and 4 the company performed the function of wholesaling through the branches which it maintained in the principal cities of the United States. Salesmen had headquarters at these branches. The size of orders, the type of service required, and other purchasing habits of customers in Groups 3 and 4 were substantially alike.

The items sold to the four groups of customers were all very similar. For instance, the company sold its mill-branded items

to Groups 2, 3, and 4. It sold the same quality of merchandise, sometimes the identical item, to Group 1, but only under private brands. The officials of the company tried to vary the appearance of an item sold to a private-brand outlet, but they stated that the quality and the cost of manufacture of these private-brand items were equal to the quality and cost of manufacture of the merchandise sold to the three other groups.

The sales manager of the company believed that 1934 was a good year in which to try to correct the chaotic price differentials existing in the trade. Rising raw material prices had affected manufacturers in receivership more seriously than companies such as the Boothby Company; hence price competition offered by the former was considerably less severe. The sales manager therefore proposed a new schedule of trade discounts, which was designed to facilitate the sale of the company's merchandise through the several types of retail outlets. The discounts in effect before August 1, 1934, and the proposed schedule were as shown in Exhibit 1.

EXHIBIT 1
BOOTHBY COMPANY
Trade Discounts

Customer Classification	Before August 1, 1934	Proposed Schedule
Group 1	Wholesale Selling List less 32%	Wholesale Selling List less 32%
Group 2	Wholesale Selling List less 28%	Wholesale Selling List less 28%
Group 3	Wholesale Selling List less 18%	Wholesale Selling List less 23%
Group 4	Wholesale Selling List less 7½%	Wholesale Selling List less 17%

The new discount plan was a compromise between what the sales manager really wanted and what he believed he could achieve at the time. In the following paragraphs is outlined the development of what he considered an ideal plan.

In formulating a theoretical discount plan to stimulate sales of the products of the company in the various types of retail outlets where the consumer might wish to buy, the sales manager believed that certain important facts had to be considered. (1) The company needed the sales volume obtained from all types of customers in order to make a net profit. (2) As a general rule the chain stores could be induced to handle the company's merchandise only if,

after adding their customary markup, they could undersell department stores and small retailers. On the other hand, the sales manager thought that a retail price differential much in excess of 10% in favor of chain stores was harmful to other retail outlets. He believed, furthermore, that chain stores and mail-order companies in Group 1 required, or at least insisted upon, a larger markup than the regional chains in Group 2. (3) Department stores normally had a higher expense ratio than chain stores or other types of retailers and on that account insisted on a large enough discount from list to compensate for their high expense. In the opinion of the sales manager, unless they could obtain that discount from his company, they would buy elsewhere. (4) The small retailers in Group 4 normally had lower expense ratios and lower markup requirements than the stores in Group 3, and frequently as low expense ratios and markup requirements as the chain stores in Groups 1 and 2. (5) The firms in Groups 1 and 2 were performing wholesale functions. Customers in Group 3 normally purchased from company branches, and customers in Group 4 either from branches or from the independent wholesalers referred to in Group 1. (6) The company needed to consider its own costs of selling to the several classes of customers as one factor in setting the differentials between classes.

The first task in working out an ideal schedule of discounts was to determine the maximum discount which customers who performed the wholesale function should receive. To this end the sales manager of the company questioned a number of wholesalers as to their operating expenses. He found that wholesalers' gross margins, including a reasonable profit, varied from 16% to 21% of sales. Since the most common figure was 18% of sales, he decided that 18% should be established theoretically as the proper maximum discount from the wholesale list price. From the standpoint of the Boothby Company the costs of selling to customers in Groups 1 and 2 differed. Though firms in both classifications were believed to be performing the same wholesaling functions, certain differences, principally in the annual volume of merchandise purchased, made the cost of selling to the second group higher. The executives therefore decided that a discount of 12% from list was most desirable for Group 2. Group 1 included 25 large national chains and mail-order companies and the independent wholesalers; Group 2 comprised between 50 and 100 sectional chains. The sales manager

expected that these firms would be satisfied with a smaller discount than that given to Group 1, because of their lower expense of operation. In his opinion they could pay the net price asked by the Boothby Company, add to it their customary markup percentage, and still compete with the larger chains and mail-order companies.

The sales manager of the company believed that the third group, which included department stores, small chains, and large retail establishments, ideally should be given a discount from list of 5%. This discount could not be justified on the basis of the Boothby Company's costs of selling. The facts were that the expense of selling to department stores and large retailers was nearly as high as that of selling to the small retailers. Whereas the cost of selling to the small stores seemed high because of their small annual purchases, selling to customers in Group 3 had proved to be nearly as costly, because this group required almost constant sales attention and expected the manufacturer to grant many expensive services, such as quick deliveries of small orders on short notice. The sales manager, however, was convinced that the company needed this class of customers, and believed, further, that, since this group incurred the highest retail cost of doing business of any of the company's customers, the only way in which the company could obtain their business was to grant them some price concessions. Hence, in his ideal plan, it seemed necessary to give this group discounts of 5% from list prices.

The sales manager thought that the fourth class, the small retailers, really ought to buy direct from the company only at wholesale list prices. The small volume obtained from these concerns made the cost of selling to them high. The officials believed that these orders should be handled either through independent wholesalers or through company branches. By selling at its wholesale list price the company would automatically afford wholesalers protection.

The foregoing analysis of the situation resulted in a suggested ideal schedule as follows:

Group 1, Wholesale Selling List less 18%
Group 2, Wholesale Selling List less 12%
Group 3, Wholesale Selling List less 5%
Group 4, Wholesale Selling List

The sales manager of the company, however, did not consider that it was expedient at the time to decrease the discounts given to

the first two groups of customers; hence he increased the discounts given to Groups 3 and 4, thereby placing the smaller purchasers in a better competitive position.

Under the plan which was proposed (see Exhibit 1), Group 1 received discounts of 32%; Group 2, 28%; Group 3, 23%; and Group 4, 17%. The relative differences between the discounts given the several classes of customers under this plan were approximately the same as under the theoretical schedule which the sales manager had worked out, provided the list prices under which the latter was operated were lower. For instance, an item listed at $1.50 in August, 1934, would yield net prices under the finally proposed schedule as follows:

Group 1, $1.50 Wholesale Selling List less 32% Equals Net Price of $1.02
Group 2, $1.50 Wholesale Selling List less 28% Equals Net Price of $1.08
Group 3, $1.50 Wholesale Selling List less 23% Equals Net Price of $1.15½
Group 4, $1.50 Wholesale Selling List less 17% Equals Net Price of $1.24½

But with a list price of $1.25 from which were allowed under the theoretical schedule 18%, 12%, and 5%, results for the various groups would be as follows: Group 1, $1.02½; Group 2, $1.10; Group 3, $1.19; and Group 4, $1.25, that is, substantially identical with the prices proposed.

Should the executive committee have accepted the recommendation of the sales manager for the new discount plan?

2. TOLLY COMPANY

SPECIAL PRICE ON A LARGE ORDER

The Tolly Company manufactured kitchen hardware and utensils, such as kettles, frying pans, dish racks, and egg beaters. It sold these products through several branch offices to retail hardware stores, furniture stores, and department stores. Sales were made also to variety chain stores. The customary markup of independent retailers on Tolly products was 35%; chain stores, however, took a markup of about 25%.

By means of a thorough sampling of branch accounts the Tolly Company had computed the data on branch sales during 1928 shown in Exhibit 1.

Analysis of the company's net sales dollar in 1928 showed the following major divisions:

Net Sales		100%
Total Factory Cost*	57%	
Total Selling (including sales administration and sales branch operations)	21	
Total General Administration	12	90
Net Profit		10%

* Raw material, 20 %; labor, 20 %; factory overhead, 17 %.

Early in 1929 a mail-order company sent an executive to the Tolly Company with an offer to place an order amounting to $1,000,000 at the price desired by the mail-order company. The goods were to be delivered unbranded during the year as required,

EXHIBIT 1
TOLLY COMPANY
Estimated Distribution of Accounts by Volume Classes, 1928

Annual Volume	Number of Accounts	Percentage	Volume	Percentage	Branch Expenses*	Percentage to Class Sales	Percentage to Total Expense
Under $100	15,233	50.7 %	$ 597,375	4.5 %	$ 184,290	30.85 %	9.94 %
$ 100–$ 250	7,325	24.3	1,194,730	9.0	238,590	19.97	12.86
$ 250–$ 500	3,971	13.2	1,260,995	9.5	256,870	20.37	13.85
$ 500–$ 750	1,526	5.1	929,400	7.0	151,864	16.34	8.19
$ 750–$1,500	1,110	3.7	1,327,500	10.0	200,585	15.11	10.82
$1,500–$3,000	606	2.0	1,194,750	9.0	152,092	12.73	8.20
$3,000–$5,000	142	0.5	6,770,250	51.0	670,255	9.90	36.14
Over $5,000	153	0.5					
Total	30,066	100.0 %	$13,275,000	100.0 %	$1,854,546	13.97 %†	100.00 %

* The figures in this column represent the sum of the costs allocated to the individual accounts in the various volume classifications. In charging expenses to the individual accounts the company used several different bases; for instance, salesmen's salaries and traveling expenses were first figured as an average cost per call, and this average cost for each salesman was then multiplied by the number of calls made by him on each customer to get the total calling cost for that customer. Shipping costs were computed on a tonnage basis, and invoices on a cost-per-line basis.

† Percentage of total branch expenses to total sales.

and the shipments would be made direct from the factory to the warehouse of the mail-order company, f.o.b. factory. This order was contingent, however, upon the agreement of the Tolly Company to give the mail-order company a discount of 19% off wholesale branch prices. The Tolly Company had had no previous dealings with this mail-order company but had sold to large chain stores at discounts varying from 10% to 15% of branch prices. These discounts had been arranged on a bargaining basis in each instance. The company could handle the order without expanding its plant or buying new machinery.

The Tolly Company was one of the leading manufacturers in the industry. There were many small plants, however, which

were endeavoring to enlarge sales volume by accepting orders at what apparently were profitless prices. The Tolly brand hitherto had enjoyed sufficient prestige with the distributing trades to offset in large part the effect of these attempts to "buy business." The Tolly brand, nevertheless, was not thought to have much weight with consumers, since it had been little advertised.

Should the Tolly Company have accepted this order?

3. SYKES COMPANY

QUANTITY DISCOUNTS

In the spring of 1929 the merchandise manager of the dress-goods department of the Sykes Company, a converter of cotton textiles, proposed a plan of quantity discounts for sales of fashion goods to department stores. The Sykes Company had the following discount schedule for one of its staple lines:

Quantity	Discount from List
Less than 25 Cases	10-5-5%
25 to 49 Cases	10-5-5-2½%
50 Cases and Over	10-5-5-5%

The proposed schedule of discounts for fashion merchandise was as follows:

Quantity	Price per Yard	Net Price per Yard
1 to 10 Pieces*	50 cents	50 cents
11 to 25 Pieces	50 cents less 2½%	48¾ cents
26 to 40 Pieces	50 cents less 5%	47½ cents
41 to 54 Pieces	50 cents less 10%	45 cents
55 Pieces and Over	50 cents less 10% and 5%	42¾ cents

* A piece normally contained 30 yards of cloth.

The proposed schedule of discounts was to apply to the 37 patterns printed on Carolin cloth, the best-selling cloth of the dress-goods department. A customer, for instance, who ordered one piece of each pattern would be billed at a price of 50 cents a yard less 5%, since the 37 pieces purchased would be within the quantity group 26 to 40; if the customer purchased 37 pieces of one pattern,

he would receive the same price. On the other hand, the buyer who purchased 10 pieces of Carolin cloth and 15 pieces of Moxub cloth, another popular dress-goods cloth, would not receive any discount for quantity purchased. If the proposed plan proved satisfactory to department store buyers and produced a greater net profit for the company, the plan would be extended to include more cloths of the dress-goods department and perhaps merchandise in other fashion-goods departments.

Increased net profits to the company from quantity sales might come both from reduced marketing expense and from lower manufacturing costs. The merchandise manager believed, moreover, that any additional business secured, even on a price basis, would be advantageous because it would distribute the overhead over a larger volume.

The chief economies from quantity selling would be reflected in manufacturing costs, which for the dress-goods department averaged 85% of net sales. The finishing cost was one-third of the manufacturing cost. On the high-style Carolin cloth, the manufacturing cost was 66% of net sales. Job finishers whom the Sykes Company patronized offered substantial reductions in their finishing charge as the size of printing order increased. For instance, on a four-color dress-goods pattern, the cost per yard of a 10,000-yard printing was 22% of the cost per yard of a 1,000-yard printing. The 10,000-yard cost was used for pricing purposes. Orders were accumulated from different customers until a 10,000-yard printing was secured. These costs applied, of course, to a single pattern, whereas the discount plan included 37 patterns on Carolin cloth. The merchandise manager had not tried to establish his price differentials entirely on the basis of cost analysis, nor had he made any allowance in the original markup for the discounts that probably would be taken by buyers under the plan.

The merchandise manager believed that under his plan department stores could be induced to place larger advance orders before the opening of their selling seasons. Fall lines of dress goods, for instance, were opened about April 15; that is, first showings were made then by converters, and first orders for fall solicited. The Sykes Company made as many sales as possible before the actual fall openings of department stores. These stores bought a wide assortment with which to start the season, and filled in on the more popular items as the season progressed.

When the proposed plan was discussed in the merchandise conference, one executive of a related fashion-goods department handling comparable merchandise stated that department stores whose buying power was considerable were demanding favorable price consideration on the basis of volume purchases during a season. These stores were seeking to obtain rebates at the close of each season of 1% to 2% of the dollar volume of purchases during the season. Department store buyers maintained that converters could afford to grant these concessions, since the buyer looked first at the line of the converter who favored him with a discount, and therefore that converter's selling cost was reduced.

Another merchandise executive, who was opposed to any quantity discounts for department stores, argued that the trend of retailing was toward hand-to-mouth buying and smaller inventories in retailers' hands. He also pointed out a further danger in the proposed plan in that buyers on fill-in orders might insist on a quantity price for a small order. Some buyers were loath to pay different prices for the same merchandise during the same season. This merchandise executive proposed that the Sykes Company encourage hand-to-mouth buying by not offering any quantity discounts.

What policy with respect to quantity prices for sales of fashion goods to department stores should the Sykes Company have adopted?

4. DOBSON COMPANY

PRICE DISCRIMINATION

The executives of the Dobson Company, which manufactured drug and toilet preparations, were attempting in 1935 to expand the distribution of one of these products, "Supremo," through drug chains. They were having difficulty, however, in obtaining orders for substantial quantities from some of the larger drug chains, because the buyers believed that the standard terms to chain drug companies did not promise sufficient gross margin to warrant handling Supremo. Frequently the buyers countered with proposals which were more advantageous to the drug chains.

The executives of the Dobson Company were considering the advisability of accepting four such proposals.

Supremo was a high-quality patented toilet preparation that the Dobson Company had begun to distribute in 1934. The product was basically different from other products for similar use and therefore needed much promotion to acquaint consumers with its advantages. A single trial by a consumer, however, frequently resulted in the creation of a permanent customer. The executives believed that there was a large potential market for the product. They had suggested a retail sales price of $1 for Supremo; the entire manufacturing cost of package and contents was 20 cents, and a reasonable estimate for advertising and sales promotional expense was 15 cents a package. Lack of funds, however, had handicapped the company in the promotion of Supremo, with the result that the product was not well known to consumers.

The Dobson Company distributed Supremo through drug wholesalers and retailers and through drug chains. Customarily the company billed wholesalers at $12 a dozen, the retail list price, less 33⅓%, which was the retailers' markup, less 16⅔% for the wholesalers' markup. The retailers' normal buying price, therefore, was approximately 67 cents, and the wholesalers' buying price nearly 56 cents for a single package. The company sold direct, at wholesalers' buying prices, to retailers who purchased in a single order as much as $48 worth of merchandise after all discounts except cash discounts. The only exception that the company had made to these terms to wholesalers or to retailers buying direct was on introductory offers for the purpose of inducing either retailers or wholesalers to carry the merchandise in stock. The terms of introductory offers permitted retailers a markup of 40% and allowed wholesalers 16⅔%. In distributing its product through drug chains, the Dobson Company ordinarily sold at the wholesalers' buying price less 10%, and in addition gave 5% of the remainder after the 10% discount in free goods.

When the proposals of the four chain store companies were received, the Dobson Company did not have retail distribution in the territories served by these chain store companies. Furthermore, the company was unable to afford the expense of the local advertising which might be needed to stimulate consumer demand and thereby obtain the cooperation of independent retail and wholesale druggists in these territories. The Dobson Company,

however, was in a position to furnish counter displays and free goods to all retailers.

Summaries of the proposals made by the buyers of the four chain drug companies were as follows:

I. FORBES DRUG COMPANY

The Forbes Drug Company operated a chain of 60 drug stores in a large city in the Middle West. In addition to nationally advertised drug and toilet preparations, the company sold under its own brand a wide variety of such merchandise.

When the president of the Dobson Company solicited an order from the buyer for the Forbes Drug Company, the latter refused to purchase at the usual terms to chains. The buyer said that he was satisfied with the quality of the product, but that it was not well known to consumers and therefore would not sell in profitable volume without aggressive sales effort. Furthermore, he believed that the price of $1 was too high for his clientele. He then proposed that his company offer the product at a retail price of 89 cents and that the Dobson Company allow the Forbes Drug Company 50% off this price and an additional 10% off the remainder. He pointed out that the Forbes Drug Company ordinarily received a 50% markup on private-brand merchandise. With such a markup on Supremo the Forbes Drug Company would be willing to push the product exactly as it did its own merchandise. He wanted the extra 10%, equivalent to 5% of the retail price, as a premium to ensure the cooperation of the salesforce.

The president of the Dobson Company believed that these terms would not permit a satisfactory gross margin for his company since net revenue after discounts of 50% and 10% from a retail price of 89 cents would be only 40 cents, or $57.67 for a gross. But he next attempted to secure from the buyer some definite commitments concerning the promotion that the Forbes Drug Company would provide in return for the liberal discounts demanded.

The buyer agreed that the Forbes Drug Company would carry out the following program for the promotion of Supremo if the Dobson Company granted the proposed discounts:

1. Counter display for one week every seven weeks
2. Two partial window displays every year in all the company's stores
3. Free representation in advertising once a month. The space would amount to about 42 lines, placed in newspapers
4. Handbills from time to time
5. Distribution of free samples,
6. An "island" display occasionally
7. Regular store-sign service

After the interview with the buyer of the Forbes Drug Company, the president made inquiries of other manufacturers of nationally

advertised drug and toilet preparations concerning the terms and the extent of cooperation which they received in dealing with the Forbes Drug Company. At first they were reluctant about disclosing their arrangements, but finally admitted that they sold under practically the same terms that the buyer had offered the president. Although they reported favorably on the promotion given their products, the president believed that he had obtained a more advantageous promotional program in the event that he decided to sell on the proposed terms.

II. PROGRESSIVE DRUG COMPANY

The Progressive Drug Company owned 75 stores all located within 250 miles of a large eastern city. The Dobson Company had no wholesale distribution in this area, and consequently no retail distribution.

The buyer for the Progressive Drug Company asked 10% off the usual wholesalers' buying price and 10% of the remainder in free goods. Under these terms the buying price for the Progressive Drug Company was 50 cents, or \$72 a gross. The drug chain would receive on every gross purchased free goods amounting to \$7.20, or 14.4 bottles free with every gross (\$7.20 ÷ 50 cents, the chain's buying price). The actual cost to the Dobson Company of the free goods with an order for a gross would be \$2.88, and the total net revenue would be \$72 less \$2.88, or \$69.12.

The president of the Dobson Company believed that, for the territory where Supremo was just being introduced, newspaper advertising would be the most effective means of building up sales volume. He therefore undertook to convince the buyer for the Progressive Drug Company that, in view of the terms demanded, he should cooperate with the Dobson Company in newspaper advertising. The buyer acquiesced and offered to grant the Dobson Company the privilege of space in the advertising of the Progressive Drug Company in the daily newspapers at 50% of the local rate; the Dobson Company was to specify the extent of space to be used.

III. LIBERTY DRUG COMPANY

The Liberty Drug Company had 28 stores located in a large city in the East. The terms requested by this company were wholesalers' buying prices less 10% and 5%; under these terms the net revenue for the Dobson Company would be about 48 cents a package, or \$68.40 a gross. If the Dobson Company granted these discounts, the Liberty Drug Company was to give window display periodically and counter display space all the time. The Liberty Drug Company was also to put on a two weeks' special "drive" twice a year, when it would use every possible promotional means, including sampling and newspaper advertising.

IV. TAYLOR DRUG COMPANY

The Taylor Drug Company owned 150 stores located in a number of cities. The terms proposed were the wholesalers' buying price less 10%

plus two packages free with each dozen purchased and an additional 5% in free goods. On this basis the buying price for the Taylor Drug Company would be 50 cents a package, or \$72 a gross. On an order for a gross the cost to the Dobson Company of the two packages free with each dozen would be \$4.80. The 5% allowance for free goods would amount to \$3.60 and at 50 cents a package would mean 7.2 packages free with an order for a gross, the actual cost to the Dobson Company amounting to \$1.44 a gross. The net revenue to the Dobson Company on this prospective order would be \$72 less \$4.80 for the cost of the two packages free with each dozen less \$1.44 for cost of free goods in the amount of 5%, or \$65.76.

If the Dobson Company accepted this offer, the Taylor Drug Company would agree not to sell below 89 cents; it had sold Supremo at lower prices. The president feared that if he did not agree to these terms, the Taylor Drug Company would bring out under its private brand an inferior product at a lower price and would attempt substitution. Despite the somewhat unfavorable terms, the president believed that the Dobson Company could secure a fairly satisfactory gross margin from sales to the Taylor Drug Company.

The executives of the Dobson Company believed that it was necessary to gain consumer recognition and build up sales volume as rapidly as possible in order to forestall competition. In 1935, although there were competing products on the market, they were decidedly inferior in quality and effectiveness. Other manufacturers, nevertheless, were watching the product; and when they realized that Supremo was conspicuously successful, they presumably would try to bring out competing products of equal quality.

Originally the Dobson Company had undertaken to sell Supremo exclusively through drug wholesalers and retailers. By following this plan the executives had hoped to maintain a one-price policy, which they considered desirable. Furthermore, since there were approximately 50,000 independent retail drug stores and only 3,000 chain drug stores, they were of the opinion that independent drug retailers would give the broadest distribution. After several months, however, they found the results of this policy unsatisfactory, for sales volume was showing no increase.

The failure of this method of distribution to increase sales rapidly caused the executives to try selling Supremo through several small drug chains. Although the company had to offer discounts of 10% from the wholesalers' buying price and an additional 5% of the remainder in free goods to induce these chains to carry Supremo, in return for these concessions the drug chains gave the

product vigorous sales support. According to the customary practice in drug chains, when an executive agreed to push a product, he sent instructions to this effect to the retail salesforce. Since the salesmen's positions depended on the successful execution of such orders, a manufacturer could be sure that his product would be sold aggressively. The Dobson Company's expense of selling to chains also was found to be low. In the first place, the president himself could interview the buyers, thereby saving the commission of the manufacturers' agent employed to sell to wholesalers; secondly, there was a saving in time and in traveling expenses.

When the executives were examining the proposals from the four large chain stores, the vice president of the Dobson Company expressed his disapproval of selling under varying terms to outlets of the same type. The vice president also was opposed to accepting the offers on the ground that such action would antagonize the independent drug stores. The president recognized this as a possibility, but he believed that it was more important to secure the business of the chains because they could give quick distribution to Supremo and also because they had a large potential volume of sales. As proof of the importance of chains in drug sales, he cited the 1933 Census figures; for instance, in 34 representative cities 1,400 chain stores obtained 39% of the total sales in contrast to the 61% secured by 13,670 independent drug stores.

The most important objection raised by the vice president was that the Dobson Company was undermining its price structure. In answer to this objection, the president stated that, if these offers and similar ones from large chain companies were accepted, he hoped for a considerable increase in sales volume. As a result, working capital would be increased despite the lower gross margin. With a reasonable expenditure of these additional funds for advertising to consumers, the Dobson Company could build up consumer demand. Then such advertising would force the independent drug retailers to buy Supremo in spite of their objections to price cutting. Furthermore, when the product had obtained strong consumer preference, the president expected to be able to revise the terms to chains.

Which, if any of these offers should the Dobson Company have accepted?

5. PUTNAM COMPANY

SINGLE-PRICE POLICY

The Putnam Company, which manufactured shoes for men and women and distributed them entirely through company-operated retail stores, prior to 1923 had sold its output at a wide range of retail prices. In 1923 the company adopted a single-price policy, selling all its shoes, both men's and women's, at $6.60 a pair. This price remained in effect until 1931, when the company lowered it to $5.85. Under the single-price policy no markdowns were taken on shoes sold at retail in the Putnam Company stores. The company did not hold special sales or clearances, and all obsolete and unsalable merchandise was returned to the factory from the stores to be sold in lots to companies which specialized in the purchase and sale of such merchandise. In 1932 the single-price policy was modified, and shoes were offered simultaneously at as many as three prices; and from that time until 1935 a variety of pricing policies were followed. By 1935 the executives were desirous of returning to the single-price policy, but they were uncertain at what point to set the price.

In 1930, after the single price of $6.60 had been in effect for seven years, sales of Putnam shoes fell off seriously. The company attributed this situation to the business depression and made every effort to arrest the decline without changing the retail price of $6.60. For instance, it manufactured and advertised for sale at $6.60 short lines of extra-value shoes. The decline continued, however, until in the third quarter of 1931 the company's sales volume was the lowest that it had been in that quarter for nearly 10 years.

At this time the executives feared that, if drastic action were not taken, the company would permanently lose the trade of many of its customers, since competitors, by reducing their prices and bringing out cheaper lines of shoes, apparently were taking away the trade of the Putnam Company. In October, 1931, therefore, the company lowered the price of its shoes to $5.85 a pair. The executives planned to maintain the same quality of materials and workmanship that had been used in the past, but during the depression they believed that it might be necessary to vary prices, temporarily, to maintain sales volume. The reduction in price

announced in October resulted immediately in an increase in total sales volume.

In 1932 the company continued its policy of not holding the January and February special sales and clearances which were common to the rest of the industry, but during the first quarter the sales of the company declined to such a point that the executives decided to lower the price to $5.55. This change in price, however, produced no appreciable rise in sales. The executives thus were puzzled as to the right price at which the company should offer its shoes; and in May, 1932, as an experiment they put the regular Putnam shoes on sale at three prices, namely, $5.55, $4.65, and $3.95. The experiment was continued through the summer until September. At that time, because large sales of shoes had been made at $5.55 and $3.95, and few shoes had been sold at $4.65, the company decided to continue selling the regular first-quality shoes at $5.55, to produce in addition a special shoe to sell for $3.95, and to abandon the $4.65 line. The company stated in its advertising that the new cheap shoe was the best it could make for that price but was not of the same quality as the regular line.

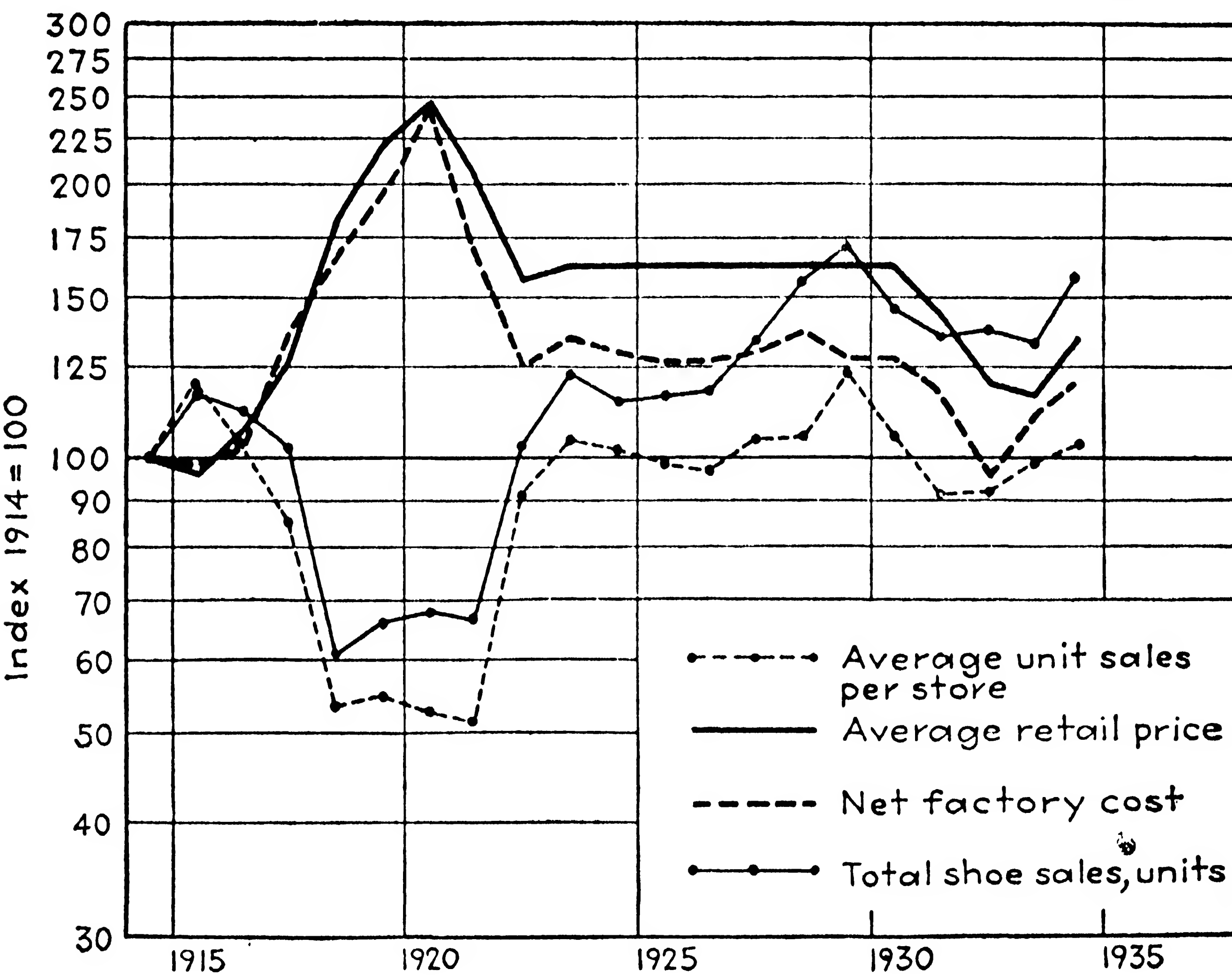
In January, 1933, the company conducted its first January sale of shoes in many years. During this sale the first-quality shoes were reduced to $4.95 a pair to meet competitive prices; the special shoe was retained at $3.95 a pair. In March, 1933, generally unsettled financial conditions caused a further decline in sales. In an effort to halt the decline, the company returned to a single uniform price, selling its first-grade shoes at $4.44 a pair and abandoning the sale of the $3.95 shoes. At the $4.44 price the company's sales volume showed a marked increase, and in the third quarter of 1933 more shoes were sold than in the corresponding quarter of 1929, the biggest year. These sales, however, were not profitable to the company, because costs of producing and selling shoes had not decreased so much as selling prices. The company, nevertheless, was willing to take the loss temporarily in order to retain its customers.

In the last months of 1933 the company raised its prices twice. In September, without advertising the fact, it raised the price of its shoes to $4.94 a pair. The executives soon decided that they could not afford to continue selling at the $4.94 price and accordingly, on the first of December, raised the price to $5.55

a pair. They believed that if they raised prices in December, the best selling month of the year, they would be in a position to lower prices later if such action appeared to be necessary as a selling appeal; or they could again add a second line in order to increase volume.

During the latter part of 1933, sales volume was low both for the Putnam Company and for the industry as a whole. In January and February, 1934, therefore, the company conducted another

EXHIBIT I.
PUTNAM COMPANY. SALES, PRICES, AND COSTS, 1914–1934.



special sales event. In January, the sale prices were $5.55 and $4.85, and in February $5.55 and $4.45.

Early in 1934 the executives of the company found it difficult to decide upon a price policy. Raw-material prices were fluctuating, and the outlook for the future was uncertain. For the time being, therefore, the $5.55 and $4.45 prices were continued, both price lines being displayed in store windows but only the higher price mentioned in the company's advertising. The policy was followed until January, 1935, when a special sale of shoes priced at $5.55, $4.45, and $3.65 was conducted.

An executive of the company stated that during the period from 1931 to 1935 it had been the company's policy to keep the quality of its shoes the same but to vary prices whenever such action was necessary in order to maintain the company's position in the industry. When lower-quality shoes had to be introduced, the company designed such shoes so that they were distinctly different in appearance from its regular lines.

Exhibit 1 shows the trend of the company's sales from 1914 through 1933 and indicates also the trend in average number of units sold per store and changes in cost and in average retail prices.

What price policy should the company have adopted for the future?

What modifications, if any, should have been made in this policy during the war boom of 1941, when wages and costs of raw materials were advancing?

6. DUMORE COMPANY

PRICE POLICY WITH RESPECT TO SMALL ORDERS

In June, 1940, the president of the Dumore Company requested Mr. Hamilton, the sales manager, to review the policy, established in March, of requiring a minimum order of $1 for all repair parts shipped by the company.

The Dumore Company manufactured a line of small hand grinders powered by fractional horsepower electric motors, which it also manufactured. These grinders ranged in price from $19.50 to $285, with the average order well over $100. Annual sales of about $250,000 were made through 120 supply houses to manufacturing concerns. Many of these distributors handled several thousand other products. One of the largest sold annually over $1,000,000 worth of material, of which $4,000 represented sales of Dumore grinders. The margin which the Dumore Company allowed the supply houses was no higher than that received on a majority of their products; and because the supply house salesmen were necessarily order-takers, for the most part, it was essential that the Dumore Company offer a product which was completely satisfactory and easy to sell. Mr. Hamilton believed that the reputation of Dumore grinders was well established.

Each supply house was expected to carry a reasonable stock of repair parts to service the grinders which it sold. Most of these distributors, however, found it impractical to keep a supply of every repair item that might be needed. Consequently, they had to order a few parts from the factory when their customers called for them. For several years prior to 1940 Mr. Hamilton had held the opinion that the supply houses were abusing the privilege of ordering one or two repair items at a time, because he believed that in almost every case a company ordering repair parts could readily include other items in the order and save money for itself as well as for the Dumore Company. During the early part of 1940 he estimated that five or six orders totaling less than $1 each were being received every day. Practically all these were from the supply house customers, although now and then a user ordered direct from the company. Mr. Hamilton watched the orders for several weeks and discovered that, although all the customers sent in some small orders, a small number of concerns seemed to be the principal offenders. In fact, one day he noticed three separate orders from the same customer, all requesting parts which cost less than $1.

Mr. Hamilton did not know the exact cost of handling an individual order; but he had noticed in the *Official Bulletin* of the American Supply and Machinery Manufacturers' Association, Inc., for May, 1940, a statement made by an executive of a supply house to the effect that the average cost of handling an order in his organization was $3. Mr. Hamilton believed that this figure was a little too high for the Dumore Company; but he knew that receiving an order, making out the invoice, withdrawing the item from stock, recording it in the stock control system, checking it against the invoice, packing it for shipping, entering it on the accounts receivable record, billing the customer, and paying the postage all amounted to a fairly large expense.

In the sales manager's opinion, every item which the company sold ought to pay its own way. He could see no reason why the profit on large orders should have to offset the loss incurred on the very small orders. Therefore he sought to ascertain the policy of other companies selling to supply houses with respect to the same problem. After a period of investigation, he wrote a report to the president, including the following quotations from replies to his requests for information:

Company A—Knowing that in many instances the cost of filling orders for small repair parts actually totals more than the invoice value, we think many companies would benefit if it were possible to establish a minimum charge for such orders.

Company B—We do not have a minimum charge for repair parts. I think sometimes we should.

Company C—We have never tried to invoke any such minimum policy; and the few small repair-parts orders that we receive are shipped and invoiced to the customer, even though we know it is, more or less, a necessary evil to the industry.

Company D—The total of the component parts of a tool, figured at list price, approximates 50% more than the published list price of the complete tool. Following this policy our minimum price for any parts such as small screws, etc., is 5 cents net list. To offset the above condition, such parts as armatures, fields, housings, gears, switches, bearings, etc., are priced so that they net us a satisfactory profit on all shipments. Often we find it necessary to explain our point of view because users sometimes have a false sense of comparative values.

Company E—We do not have a minimum charge of 50 cents or $1 for repair parts. Whatever the repair parts amount to is what we bill the customer. That is the way we have been handling it up to this time.

Company F—We do not have any minimum charge for repair parts.

Company G—We have never established a minimum for this purpose but believe it would be a very good thing for the entire electric tool industry.

Company H—We make a minimum charge of 50 cents on part orders that come in for less than this amount. We found that it would hardly pay us to accept them for any less.

Company I—Some years ago, in an effort to eliminate billing expense on parts that were less than 50 cents, we decided to supply them at no charge. What we endeavor to do when a customer orders one brush or brush plug is try to sell him on the idea of buying an extra pair of brushes or brush holder plugs. We have been fairly successful in having our service men put this idea across, and it has resulted in the elimination of a lot of small charges. We also try to make all such transactions on a cash basis.

Mr. Hamilton's report went on to say:

As can be seen, the policy of having minimum repair parts charges is limited to but one company, Company H. All others, including ourselves, feel that it is a situation which is aggravating in one sense, but which is not big enough in the other to do much about.

The general consensus of opinion is that these minimum repair parts charges are a possible source of customer discontent. I think, however, that we can overcome this obstacle and still invoke a minimum charge if we would follow the practices of Company J, which includes the following notice with each price list for repair parts:

"When you order goods from a manufacturer, the cost of filling a single order is almost exactly the same, whether the amount of your order is a hundred dollars or five cents. In fact, the actual cost of filling the five-cent order in many cases is greater than that of the hundred-dollar one.

"This naturally means that on every order under a certain amount the manufacturer actually loses money. This is the reason why many manufacturers 'pad' their repair-parts prices and why many others have a rigid minimum-order amount—in order to offset, to some extent, the losses incurred in filling a large volume of small orders.

"We like to be fair with our customers in every way possible. We go to the trouble of listing in our instruction pamphlets the exact size of every standard screw, nut, washer, and similar part in our machines, so that the customer may save himself time and money by obtaining these standard parts locally if he so desires. And we do not like to 'pad' our repair-parts prices.

"But we are working under the same conditions as all other manufacturers, and naturally we are subject to exactly the same kind of losses on small orders.

"We should appreciate your cooperation very much, therefore, if you would obtain all your standard repair parts such as screws, nuts, bolts, etc., from a local source of supply.

"If you prefer to order direct from us, we shall be pleased to be of the utmost possible service. We should appreciate it, however, if you would select enough parts to bring the amount of your order to at least eighty-five cents (85 cents).

"This will enable us partly to eliminate one source of loss and will help us to give you still better machines for your money. Thank you."

Despite the fact that, on the basis of these reports, other companies seemed to have done very little about the problem, Mr. Hamilton was firmly convinced that small orders should bear a more equitable portion of their cost. He believed that reasonable customers would understand the situation and that unreasonable customers were not likely to be good customers of the Dumore Company in any event. He decided, therefore, to experiment with a plan which required a minimum order of $1. In order to inform customers of the plan, he sent out a bulletin notifying them that in the future no order for less than $1 would be accepted. If customers needed a part which cost less than $1, they were asked to include something else in the order to bring it up to the minimum. The bulletin pointed out that the management realized that all the supply houses were faced with the same problem in handling small orders, and it advised them to request their customers to order reasonable quantities each time.

After the bulletin had been distributed to all the customers of the Dumore Company, any orders received for less than $1 were referred to the order clerk, who sent a card to the customer asking him if he would like to increase the size of his order. If the order was marked "rush," it was shipped without delay and the customer was billed $1.

When the president of the Dumore Company returned to the office after a prolonged business trip some time after the new policy had been inaugurated, he was not a little perturbed and asked Mr. Hamilton to discuss the matter with him. The president pointed out that the business of the mill supply houses to which the company sold its output had been built up on the basis of service to their customers and that the supply houses had come to expect the manufacturers to help them give this service. Furthermore, he stated that the goodwill of the supply houses was essential, because they could very easily neglect the sale of the Dumore line even though they kept it in their catalogues for anyone who demanded it. He believed that the supply houses might resent the principle of charging $1 for a 25-cent item, even though the additional cost would not amount to a great deal in the long run.

In replying to the president the sales manager argued that a few charges of $1 would not affect the goodwill of the Dumore Company's customers. He was convinced that most of the supply houses would consider the plan reasonable, and he could see little likelihood of provoking ill will if specific complaints were handled tactfully. He pointed out that only two complaints had been received since the policy had been inaugurated three months previously, and he believed that the company's reply in each case had satisfied these concerns, since nothing more had been heard from them. The correspondence relating to these complaints was as follows:

CLEVELAND, OHIO

March 13th, 1940

The Dumore Company
Racine, Wisconsin
Attention Mr. Hamilton,
Sales Manager

Subject: Minimum Billing

GENTLEMEN:

We want to go on record as taking exception to the policy which you contemplate following, as outlined in yours of the 6th relative to a minimum billing on any one order of $1.00 net.

In the first place, as your records will show, we sell considerable Dumore merchandise in the course of a year. You will also find that in the course of a year we order considerable in the way of parts, belts, etc., for Dumore Grinders. We do try to carry belts in stock but if you think for one moment we can get by with our regular customers in trying to charge them $1.00 for something that is worth 15 or 20 cents, you have another guess coming, and we can tell you now that it is going to have considerable effect on your sales.

You will appreciate the fact that we in our retail mill supply business cannot make any money on charges or even cash sales that involve anywhere from 5 to 50 cents. As a matter of fact on a good many items in our mill supply line we would be better off giving it to the customer than trying to put it on our books. It costs us about 17 cents to put a charge through, and when you stop to think, on some items that involve only 25 cents we are actually losing money. But still we have a lot of good customers who come in here and want something in a hurry, and we certainly haven't nerve enough to charge them on a minimum basis of $1.00 for something that really ought to sell for 10 or 15 cents. As a matter of fact we tried it on a basis of 50 cents, and had so many complaints that we finally reduced the minimum charge to 25 cents; but if a customer will come in here and buy a couple of carriage bolts or washers, or a little piece of brass, we will sell it to him for cash for whatever the price might be, and the minimum charge on a cash sale is 10 cents.

It does seem to us that if we are willing to go to all the trouble and expense involved in the sale of some small item less than $1.00, you ought to be willing to do your part in keeping customers in the field thoroughly satisfied with Dumore products. Your Mr. Bill Thronson is here, and we are giving him our personal reaction on this, and he undoubtedly will write and tell you just how we feel about it; but we want to go on record with you now, in case Bill does forget it, that we do not approve of this policy.

Yours very truly,
J. G. James
Sweet, Crane & Company

March 14, 1940

Mr. J. G. James
Sweet, Crane & Company
Cleveland, Ohio
Dear Mr. James:

I have your letter of the 13th and agree with you very heartily about minimum billing. If all of my distributors were as fair in ordering as you have been, I wouldn't have any problem; but when you have a couple of lamebrains who insist on buying three felt washers, total value 3 cents, and then don't include stamps for their purchase but expect us to enter, ship, bill, invoice and then carry it on our statements, I think we have a justifiable complaint.

In reality this minimum billing is not going to be very difficult, for most of our merchandise sells around 50 cents or $1.00. A man ordering a belt really should have two belts instead of one. We always supply two with a grinder, and two would take care of the minimum billing.

On items around 10 cents, we usually stick them in a mailing bag and send them no charge in order not to carry the thing on our books.

In the future if you feel that this will inconvenience you, kindly disregard our minimum billing. We will be glad to cooperate with you in any way we can.

I've often thought that we must lean on you distributors as our guideposts to the best way of handling business; and if this generous suggestion on your part has done nothing more than to bring to our attention the difficult situation, I am sure your dictating the letter was very much worth while.

With kindest personal regards, I am

Sincerely,
THE DUMORE COMPANY
Robert L. Hamilton
Sales Manager

CLEVELAND

March 11, 1940

The Dumore Company
Racine, Wisconsin
Attention—Mr. Hamilton
GENTLEMEN:

In connection with your bulletin of the 6th regarding minimum billing, I question somewhat whether your policy is entirely fair to your distributors.

The question of small orders is a serious one for both manufacturers and distributors; and in our Association activities, there has been a lot of talk and discussion. From time to time, I have investigated and I have about reached the conclusion that we, as a distributor, must reconcile ourselves to the fact that we are in a small-order business. In fact, we have been in it for the 42 years we have been in business.

Now after listening to some of the speeches about small orders, the amazing thing is that we and 200 or 300 of our competitors are still in business and in normal times make money. Therefore, as stated above, I have reached the conclusion that it isn't anything very much to worry about. True, we lose money on small orders but on the other hand, we build up a lot of goodwill and get a lot of orders because of this service.

Now, let us discuss for a moment the situation as it applies to you as a manufacturer. I have looked over your invoices and I find that out of 115 invoices, only 8 were less than $1.00 and that the amount

of such orders was $3.64. Now, isn't it fair to assume that you could well afford to ship us these 8 orders at a loss in view of our volume of business over that time? And furthermore, isn't it somewhat your responsibility to see that your ultimate consumers receive these small parts at a very reasonable cost?

The reason I am taking this matter up with you is first that we cannot put a minimum charge of $1.00 (or if we add profit, say $1.30) into effect if one of our customers comes to us and wants some small part of your equipment. We feel in duty bound to furnish it at the lowest possible price; and on the other hand the demand for these parts is so small that they are not considered by us as stock, and I believe you will agree that your distributors cannot carry such parts in stock.

You speak about consolidating orders; but this is impractical, because our customer may need the part for his equipment and any delay will hold up production, and he cannot wait until we have a stock shipment coming in.

What your action will mean to us is that we, as your distributor, must take a loss, because if one of our customers wants a 28-cent item that is what we will have to give him, and you are penalizing your distributor. Now, if we can do it, I believe that you, as a manufacturer operating on a manufacturer's profit, can also do it.

I believe that this action on your part has been brought about through the fact that there has been a considerable amount of publicity on small orders, and that while some of it is undoubtedly justified, the subject has become exaggerated as to its importance beyond its real seriousness.

Thanking you for giving this matter reconsideration, we remain

Yours very respectfully,
R. J. Huff
THE HANSON TOOL & SUPPLY COMPANY

March 13, 1940

Mr. R. J. Huff
The Hanson Tool & Supply Company
Cleveland, Ohio
Dear Ralph:

I have your letter of March 11, and can agree with you on every point 100%. You're a good house and that is why you only had eight items less than $1.00 out of 115 invoices.

But what are you to do when you have a distributor, and I'm going to mention the name now, like the Jones Company which orders a mounted wheel. Visualize this. They get an order from their customer and have to order the mounted wheel from us. We enter the order and it goes to our small-order department, through the receiving room and shipping room, billed, and finally the invoice put on our books. Total gross 43 cents. Net profit absolutely nothing.

Now if Jones was ordering a mounted wheel for their customer, they should have said, "Dumore has a minimum charge. Instead of ordering one mounted wheel why not order two or three?" Then there is no argument.

On the other hand, I remember a distributor ordering three filters for a #8 hand grinder. We sell these filter pads at 1 cent apiece and we had to bill them out at 3 cents. So I've gotten to this point. If the order is less than 10 cents I just stick the material in a mailing bag and send it out no charge, not even shipping or billing it. If it is over that we try to give sufficient usable merchandise that a man can actually use, and we bill him at $1.00.

The Smith people have set up a minimum charge of $2.00, and I think you are going to find more and more manufacturers coming to this type of thing. I know you distributors have a problem, Ralph, and it's a tough one. In order to ease the burden I have taken part of the responsibility and set this minimum charge, so if you want to blame anyone, you can blame it onto me.

Speaking of those eight invoices, they no doubt were for parts such as one belt, list price 50 cents. Well, the customer is going to use another belt on the grinder, so why not order two belts for him? Then he has it and there is no trouble anywhere along the line. I don't think we are going to get into any great difficulty, but we will give it a whirl, Ralph, and see how it works out. Possibly you and I can get together one of these days and discuss it personally.

I want you to know that I look to you for a good deal of advice on the procedure of selling in the industrial field, and I'll be happy to keep you posted as to how we are making out.

Sincerely,
THE DUMORE COMPANY
Robert L. Hamilton
Sales Manager

7. W. R. HAINES COMPANY

TREATMENT OF EXECUTIVE SALARIES, TRAVELING, AND ENTERTAINMENT COSTS ON GOVERNMENT CONTRACTS

Carburetors of various types, primarily for use in airplanes, were manufactured by the W. R. Haines Company. In early 1940, about 10% of the company's business consisted of production for contracts with the United States War and Navy Departments. The company was small and closely held, most of the stock being owned by officers and other employees.

The governmental departments purchased chiefly standard carburetors, but the purchases were divided into several contracts

made during the year. At the end of any year in which the company had government contracts, the War and Navy Departments jointly audited the books of the company. This procedure was followed despite the fact that the contracts were not large enough to be subject to the Vinson-Trammell Act and even though most of them were let after competitive bidding on a fixed-price basis; for it was held that the competitive bidding itself included something of the nature of negotiated contracts, since the Army favored the products of certain manufacturers in various lines as being superior or more in conformity with Army specifications. Furthermore, since one company might specialize in a type of product which was particularly satisfactory for governmental uses, it could usually afford to bid a lower price than could its competitors and still might secure a larger profit than the government considered reasonable.

In order to prevent suppliers from obtaining excessive profits, the War and Navy Departments conducted these audits to ascertain (1) the company's costs of operation during the year and (2), from the cost and contract price figures, the profit margins which the company had obtained on government contracts. When new contracts for items previously obtained from a particular company were advertised for competitive bidding and the audits of the company seemed to indicate that it had obtained an excessive profit on the previous order, War and/or Navy Department officials commonly visited the company and asked that a lower bid be made by it on the new contract under consideration.[1]

The chief problem faced by the Army auditors in making their annual audits was that of attempting to define which costs were

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[1] Excerpts from T.D. 5000, Subchapter A, Part 26, "Excess Profits on Contracts for Naval Vessels and Army and Navy Aircraft," were as follows:

"Sec. 26.9 *Cost of performing a contract or subcontract.* (*a*) *General rule.* The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs (including therein a reasonable proportion of management expenses) incident to and necessary for the performance of the contract or subcontract.

"(*b*) *Elements of cost.* No definitions of the elements of cost may be stated which are of invariable application to all contractors and subcontractors. In general, the elements of cost may be defined for purposes of the Act as follows:

"(1) Manufacturing cost, which is the sum of factory cost (see paragraph (*c*) of this section) and other manufacturing cost (see paragraph (*d*) of this section);

"(2) Miscellaneous direct expenses (see paragraph (*e*) of this section);

"(3) General expenses, which are the sum of indirect engineering expenses, usually termed "engineering overhead" (see paragraph (*f*) of this section) and

applicable to government contracts. It was easy enough to define the general policy of accepting as costs those which pertained logically to government contracts; but difficulties arose in the attempt to allocate the general expenses of the business which were applicable to both commercial and military contracts but impossible to assign directly to the particular contracts. An important problem in defining costs for the 1939 Army and Navy audit of the W. R. Haines Company was the treatment of administrative, traveling, and entertainment costs.

The governmental departments had established a general policy of prorating general and administrative expenses attributable to all types of contracts between government and commercial contracts in proportion to the volume of sales in each group. Such

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expenses of distribution, servicing and administration (see paragraph (*g*) of this section); and

"(4) Guarantee expenses (see paragraph (*h*) of this section).

. . . .

"(*g*) *Expenses of distribution, servicing and administration.* Expenses of distribution, servicing and administration, which are treated in this section as a part of general expenses in determining the cost of performing a contract or subcontract (see paragraph (*b*) of this section), comprehend the expenses incident to and necessary for the performance of the contract or subcontract, which are incurred in connection with the distribution and general servicing of the contracting party's products and the general administration of the business, such as—

"(1) *Compensation for personal services of employees.* The salaries of the corporate and general executive officers and the salaries and wages of administrative clerical employees and of the office services employees such as telephone operators, janitors, cleaners, watchmen, and office equipment repairmen.

"(2) *Bidding and general selling expenses.* Bidding and general selling expenses which by reference to all the pertinent facts and circumstances reasonably constitute a part of the cost of performing a contract or subcontract. The treatment of bidding and general selling expenses as a part of general expenses in accordance with this paragraph is in lieu of any direct charges which otherwise might be made for such expenses. The term "bidding expenses" as used in this section includes all expenses in connection with preparing and submitting bids.

"Allowances for interest on invested capital are not allowable as cost of performing a contract or subcontract.

"Among the items which shall not be included as a part of the cost of performing a contract or subcontract or considered in determining such cost, are the following: Entertainment expenses; dues and memberships other than of regular trade associations; donations except as otherwise provided above; losses on other contracts; profits or losses from sales or exchanges of capital assets; extraordinary expenses due to strikes or lockouts; fines and penalties; amortization of unrealized appreciation of values of assets; expenses, maintenance and depreciation of excess facilities (including idle land and building, idle parts of a building, and excess machinery and equipment) vacated or abandoned, or not adaptable for future use in performing contracts or subcontracts; increases in reserve accounts for contingencies, repairs, compensation insurance (except as above provided with respect to self-insurance) and guarantee work; Federal and State income and excess-profits taxes and surtaxes; cash discount earned up to one per cent of the amount of the purchase, except that all discounts on subcontracts subject to the Act will be considered; interest

a policy was not too successful if followed rigidly, however, particularly in the case of small companies owned largely by their executive officers, which were able to distribute all profits in the form of executive salaries if the executives themselves believed that method to be advantageous. Thus, for companies no larger than the Haines company, which had annual sales of less than $1,000,000, the War and Navy Departments had established a maximum allowance of $45,000 per year as a total for the top three executives. Salaries in the Haines company for its three top men were as follows: for the president, $50,000; for the first vice president, $20,000; and for the second vice president, $15,000. Of the $50,000 paid to the president about $14,000 was classed by the company as a selling expense, since it represented the total amount of commissions pa d him and selling expenses incurred by him for sales which he himself made to industrial concerns. His expenses were approximately $6,000 of this $14,000 total; but the total amount was paid to him in a flat sum, and he was not required to maintain an expense account. At the end of 1939 the company had also paid bonuses out of its net profits as follows: $10,000 to officers, $12,000 to sales officers and salesmen, and $25,000 to factory employees.

Included with the aforementioned items in the company's general and administrative expenses was a charge of $2,000 for entertainment, which represented chiefly salesmen's costs in entertaining prospective industrial customers. Another classification consisted of traveling expenses and engineering service work amount-

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incurred or earned; bond discount or finance charges; premiums for life insurance on the lives of officers; legal and accounting fees in connection with reorganizations, security issues, capital stock issues and the prosecution of claims against the United States (including income tax matters); taxes and expenses on issues and transfers of capital stock; losses on investments; bad debts; and expenses of collection and exchange.

. . . .

"(i) *Unreasonable compensation.* The salaries and compensation for services which are treated as a part of the cost of performing a contract or subcontract include reasonable payments for salaries, bonuses, or other compensation for services. As a general rule, bonuses paid to employees (and not to officers) in pursuance of a regularly established incentive bonus system may be allowed as a part of the cost of performing a contract or subcontract.

"The test of allocability is whether the aggregate compensation paid to each individual is for services actually rendered incident to, and necessary for, the performance of the contract or subcontract, and is reasonable. Excessive or unreasonable payments whether in cash, stock or other property ostensibly as compensation for services shall not be included in the cost of performing a contract or subcontract."

ing to $14,000, broken down as follows: a trip to Europe by the president, stated to be a trip for the purpose of studying European manufacturing methods, $1,500; trips throughout the United States by the sales manager to supervise commercial sales, $5,500; salesmen's traveling expenses, $3,000; and engineering work in connection with service for customers, including both commercial and military customers, $4,000.

Another item which was listed as a general expense was the upkeep and depreciation on a yacht owned by the company and used for various purposes. Executive officers of the company often made use of this yacht during week ends for the purpose of entertaining prospective customers. The yacht had also been of service in other ways; hence the Haines company believed that there was adequate reason for allocating 10% of the yacht's upkeep and depreciation to the cost of Army and Navy contracts. For instance, the War and Navy Departments had found it necessary during 1939 to make a study of the plant and the surrounding harbor in order to plan for defense against aerial attacks. The company had offered the use of the yacht for this survey and thus eliminated the cost of chartering a boat especially for the purpose. On another occasion the yacht had been used for following the maneuvers of a flying boat which the company was using for testing its carburetors. The flying boat met with trouble on one test and was forced down several miles out at sea, whereupon it was pursued by the yacht and salvaged without any serious loss. This flying boat was valued at over $50,000; and the management felt that the yacht in this single instance had earned a year's upkeep many times over, since otherwise the flying boat would have been a complete loss, which could have been charged to the company's expense account for 1939. The cost of upkeep for the yacht amounted to about $12,000 per year, and on it the company also charged depreciation amounting to $3,000 per year.

Which, if any, of these various outlays should have been allowed as costs of performing the government contracts?

XI

LEGISLATIVE REGULATION OF PRICES

1. SOME NOTES ON FAIR TRADE LEGISLATION

In December, 1937, M. P. McNair summarized the scope of the term "fair trade legislation" and made a few comments in an address before the American Marketing Association, as follows:[1]

The term "fair trade legislation" embraces a variety of restrictions on pricing freedom. With reference to the relations between commercial buyers and sellers, that is, manufacturers, wholesalers, and retailers, there is the well-known Robinson-Patman Act, aiming to prevent so-called price discrimination accomplished either directly, or indirectly by collateral transactions between buyers and sellers regarded in the law as tantamount to pricing subterfuges. These restrictions are aimed principally at buying practices. Other types of fair trade legislation are directed at the selling end and especially at retail pricing practices, that is, at pricing relations between retailers and consumers. Here the principal form of restriction consists of the state price maintenance acts, commonly referred to as fair trade acts, and the supporting Federal measure, the Miller-Tydings Act, the effect of which is to give manufacturers of trade-marked goods in some 42 states[2] the privilege of stipulating resale prices and, by means of a contract made with one distributor, enforcing those resale prices on all the distributors handling the product. Resale price maintenance of course applies only to trade-marked goods and is permissive rather than mandatory. Another type of legislative restriction, designed primarily to curb freedom of action in setting selling prices, is represented by the various unfair trade practices acts now on the statute books of some 15 states.[3] These laws, which apply not merely to branded merchandise but to all merchandise, and which, of course, are mandatory rather than discretionary, have as their general purport the prohibition of sales below cost, cost being defined sometimes as invoice cost, sometimes as invoice cost plus some stated percentage, such as 6% or 10%, and sometimes, as in the case of California, invoice cost plus the entire cost of doing business. Such enactments are in general to be distinguished from the statutes, mostly of long standing,

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[1] Malcolm P. McNair, "Fair Trade Legislation and the Retailer," *The Journal of Marketing*, Vol. II, No. 4, April, 1938, pp. 295–300.

[2] As of early 1942, 46 states.

[3] As of early 1942, 31 states.

which follow the Clayton Act in forbidding locality discrimination, though sometimes the two are combined. . . .

Simply from casual observation, however, one may venture a few comments. The Robinson-Patman Act has had some slight "moral" effect in causing revision of discount schedules and alteration of practices with respect to advertising allowances, demonstrators, and so on. A substantial list of complaints has been issued by the Federal Trade Commission; but there were also a number of situations in which the Commission, after making an investigation, did not issue a complaint. It may further be remarked that the grounds on which the Bird case and the Kraft-Phenix case were dismissed were such as to indicate a reasonable attitude on the part of the Commission. On several of the most controversial points, including the much-disputed clause on brokerage, the Act awaits court interpretation. In the meantime it has caused no very profound revolution in buying practices.

With respect to the several state measures forbidding sales below cost, variously defined, either administrative procedure has settled down to some relatively uniform basis of attempted enforcement, such as cost plus 6%, or else, as in the case of California, the more ambitious efforts to embrace a larger part of the merchant's expense of doing business under the term "cost" within the meaning of the law still await a final test of strength. . . .

State resale price maintenance laws, having been upheld by a decision of the United States Supreme Court, are in a different category from either the Robinson-Patman Act or the various state enactments outlawing the practice of selling below cost. The two latter types of restriction on pricing freedom still must take their chance in the courts.

In the case of the resale price maintenance laws, general observation suggests that the present situation is about as follows:

1. No very high percentage of manufacturers of trade-marked goods are availing themselves of the privileges extended.

2. Many of those manufacturers who have named resale prices have done so primarily because of pressure from some of their customers and not because of conviction that the policy is sound.

3. In some trades there is definite organized pressure from retailers using such devices as "white listing" to coerce manufacturers into writing resale price maintenance contracts.

4. There is evidence that retailers, particularly in the drug field, desire to increase the guaranteed percentages of gross margin and even hope to obtain uniformity of these percentages in all the states having price maintenance laws.

5. There was for a time some diminution of retail price wars on items of branded merchandise, but now the current business recession is encouraging a breakdown of established resale prices.

6. Some manufacturers, disturbed at the slow movement of merchandise through retail channels, have not been wholly averse to a resumption of retail price cutting; and several manufacturers who

have written resale price maintenance contracts with retailers have themselves inaugurated deals and promotions of various kinds, such as two-for-one sales, that have resulted in goods being placed in consumers' hands at prices lower than those stipulated.

7. Some large department stores and chain stores have definitely increased their use of private brands.

8. Consumers, irked by high prices, are increasingly seeking out unorthodox channels for the purchase of major items of household equipment in order to obtain either open or clandestine price advantages.

2. ROBINSON-PATMAN ACT[1]

PRICE DISCRIMINATION

Section 2 of the Clayton Act, relating to price discrimination, reads as follows:

Sec. 2. That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly to discriminate in price between different purchasers of commodities, which commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce: *Provided*, That nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of differences in the grade, quality, or quantity of the commodity sold, or that makes only due allowance for difference in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition; *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting

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[1] See symposium on *Price Discrimination and Price Cutting* published as the June, 1937, issue of *Law and Contemporary Problems* (Durham, Duke University Law School), especially the article on "Marketing Functions and Cost and the Robinson-Patman Act," by Malcolm P. McNair.

See also: "The Robinson-Patman Law: Some Assumptions and Expectations," by Edmund P. Learned and Nathan Isaacs, *Harvard Business Review*, Vol. XV, No. 2, Winter, 1937; "The Problem of Administering the Robinson-Patman Act," by Melvin T. Copeland, *Harvard Business Review*, Vol. XV, No. 2, Winter, 1937; *The Robinson-Patman Act: Its History and Probable Meaning* (Washington, The Washington Post, 1936); and *Manual on the Robinson-Patman Act*, prepared for the use of The Great Atlantic & Pacific Tea Company and Subsidiary Companies by Feldman, Kittelle, Campbell & Ewing, Washington (Copyright, 1940, by The Great A. & P. Tea Co.).

their own customers in bona fide transactions and not in restraint of trade.

In June, 1936, Congress undertook to strengthen and change this section by passing the Robinson-Patman Act, which follows:

To amend section 2 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914, as amended (U.S.C., title 15, sec. 13), and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 2 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914, as amended (U.S.C., title 15, sec. 13), is amended to read as follows:

Sec 2. (*a*) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided,* That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: *Provided, however,* That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: *And provided further,* That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: *And provided further,* That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods,

distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

(*b*) Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: *Provided, however,* That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

(*c*) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transaction other than the person by whom such compensation is so granted or paid.

(*d*) That it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(*e*) That it shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

(*f*) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

Sec. 2. That nothing herein contained shall affect rights of action arising, or litigation pending, or orders of the Federal Trade Commission issued and in effect or pending on review, based on section 2 of said Act of October 15, 1914, prior to the effective date of this amendatory

Act: *Provided*, That where, prior to the effective date of this amendatory Act, the Federal Trade Commission has issued an order requiring any person to cease and desist from a violation of section 2 of said Act of October 15, 1914, and such order is pending on review or is in effect, either as issued or as affirmed or modified by a court of competent jurisdiction, and the Commission shall have reason to believe that such person has committed, used or carried on, since the effective date of this amendatory Act, or is committing, using or carrying on, any act, practice or method in violation of any of the provisions of said section 2 as amended by this Act, it may reopen such original proceeding and may issue and serve upon such person its complaint, supplementary to the original complaint, stating its charges in that respect. Thereupon the same proceedings shall be had upon such supplementary complaint as provided in section 11 of said Act of October 15, 1914. If upon such hearing the Commission shall be of the opinion that any act, practice, or method charged in said supplementary complaint has been committed, used, or carried on since the effective date of this amendatory Act, or is being committed, used or carried on, in violation of said section 2 as amended by this Act, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and serve upon such person its order modifying or amending its original order to include any additional violations of law so found. Thereafter the provisions of section 11 of said Act of October 15, 1914, as to review and enforcement of orders of the Commission shall in all things apply to such modified or amended order. If upon review as provided in said section 11 the court shall set aside such modified or amended order, the original order shall not be affected thereby, but it shall be and remain in force and effect as fully and to the same extent as if such supplementary proceedings had not been taken.

Sec. 3. It shall be unlawful for any person engaged in commerce, in the course of such commerce, to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity; to sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.

Any person violating any of the provisions of this section shall, upon conviction thereof, be fined not more than $5,000 or imprisoned not more than one year, or both.

Sec. 4. Nothing in this Act shall prevent a cooperative association from returning to its members, producers, or consumers the whole,

or any part of, the net earnings or surplus resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association.

Approved, June 19, 1936.

3. CARSTAIRS PRODUCTS COMPANY

FAIR TRADE (RESALE PRICE MAINTENANCE)[1]

Late in 1937, the executives of the Carstairs Products Company were considering what action to take in regard to writing price maintenance contracts with distributors of Carstairs products. The company had been subjected to a considerable amount of pressure from independent retail grocers and from wholesalers selling to independent retailers, who, following the decision of the Supreme Court validating the Illinois and California Fair Trade Acts, and the passage of the Miller-Tydings Act, had expressed their desire for price maintenance agreements. Most of the large chain grocery organizations, on the other hand, were firmly opposed to price fixing of any character.

The Carstairs Products Company manufactured and distributed breakfast cereals, which were sold direct to chain stores and to wholesalers selling to independent retail grocers. The company employed missionary salesmen, who called upon retailers and endeavored to stimulate the flow of Carstairs products through retail stores to consumers. Carstairs products were nationally advertised and competed with a wide variety of nationally advertised products, as well as with unadvertised merchandise under manufacturers' brands and with merchandise under wholesalers' or chain store brands. Several of the company's products had been, for many years, among those frequently selected for price cutting, and the executives of the company had become accustomed to the complaints of wholesalers and independent retailers that the sale of Carstairs products was not profitable.

In 1936, excluding sales to hotels, restaurants, and institutions, the company had made 34% of its sales to corporate grocery chains, 32% to voluntary chains, 28% to wholesale grocers without retail affiliations, 5% to retailer-owned wholesale grocers, and 1% direct

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[1] See Ewald T. Grether, *Price Control under Fair Trade Legislation* (New York, Oxford, 1939).

to retailers. The company did not pack its products for distribution under private brands. Its executives believed that with one or two exceptions cereal manufacturers with leading advertised brands of their own followed a similar policy. There were on the market, however, numerous private brands of oatmeal, corn flakes, farina, and other cereal products, and it was believed that sales of private-brand merchandise constituted about 20% of total cereal sales.

Expenditures for advertising by the leading cereal manufacturers in 1935 were as shown in Exhibit 1. Production statistics for

EXHIBIT 1

EXPENDITURES OF LEADING MANUFACTURERS FOR ADVERTISING CEREALS TO CONSUMERS: MAGAZINES, NEWSPAPERS, AND RADIO, 1935

Company	Magazines	Newspapers	Radio
Carstairs Products Company	$517,327	$ 73,900	$493,198
Cream of Wheat Corporation	398,644	30,120	
General Foods Corporation	295,364	1,107,353	501,646
General Mills, Inc.	190,090	69,817	
Hecker Products Co.	....	205,294	156,722
H. J. Heinz Company	....	48,753	
Kellogg Company	256,192	3,302,916	482,242
National Biscuit Company	273,826	1,166,252	
Pillsbury Flour Mills Co.	4,691		
Quaker Oats Company	334,838	1,008,076	
Ralston Purina Co.	62,424	544,138	123,990
Wheatena Corporation	....	....	249,499

Source: Figures based on data from Curtis Publishing Company, *Leading Advertisers;* Media Records, Inc.; and Publishers' Information Bureau, Inc.

breakfast foods, as reported by the Census of Manufactures, were as shown in Exhibit 2.

Executives of the Carstairs Products Company were seriously disturbed by their position between two groups of distributors with opposing interests. Whether the company took action for or against price maintenance, it could not help antagonizing a large proportion of its customers, who had it in their power to initiate retaliatory action inimical to sales of the company's products. The difficulty of the situation was increased by the competition of other manufacturers and distributors, whose policy with regard to price maintenance would directly affect the successful execution of the policy of the Carstairs Products Company. Yet the attempt to

refrain from expressing either a willingness to write price maintenance contracts or opposition to such action—in short, the attempt to maintain a position of neutrality—might result in inviting retaliatory action by both the opposing interests.

A memorandum by the vice president in charge of sales, analyzing the situation with regard to price maintenance, declared that the request for price maintenance contracts was supported by a

EXHIBIT 2

PRODUCTION STATISTICS FOR BREAKFAST FOODS, 1929, 1933, AND 1935

	1929	1933	1935
Number of Establishments	121	103	110
Value of Products	$175,223,126	$111,025,686	$ 146,681,038
Cereal Preparations	$131,353,947	$ 87,038,917	$ 115,172,881
Other Products	$ 43,869,179	$ 23,986,769	$ 31,508,157
Cereal Preparations Made as Secondary Products in Other Industries	$ 37,354,310	$ 21,026,357	$ 20,000,281
Breakfast Foods:			
Total Pounds	....	....	1,092,049,968
Total Value	$121,106,824	$ 76,201,745	$ 95,892,260
Made from Wheat:			
Pounds	....	333,217,789	380,050,912
Value	$ 47,385,735	$ 33,967,531	$ 43,603,164
Made from Oats:			
Pounds	718,382,081	642,682,510	497,874,305
Value	$ 36,419,309	$ 19,018,849	$ 25,238,915
Made from Corn:			
Pounds	383,867,163	236,983,053	176,772,561
Value	$ 27,458,433	$ 17,286,407	$ 18,680,294
Made from Other Grains:			
Pounds	58,365,080	....	37,352,190
Value	$ 9,843,347	$ 5,928,958	$ 8,369,887

Source: U.S. Bureau of the Census, *Biennial Census of Manufactures, 1935* (Washington, Government Printing Office, 1938).

considerable number of independent retailers and by wholesalers selling to them. These types of distributors were opposed to price cutting of nationally advertised brands as practiced by chain store companies and by supermarkets. Price cutting by these concerns had been met to some extent by the independents and had reduced their gross margins. The independents believed generally that the only action necessary to restore gross margins was to fix prices. Many of the independents also believed that the Carstairs Products Company should fix prices at relatively higher levels.

There were several methods which might be adopted to force manufacturers to write price maintenance contracts. Wholesalers had already requested strongly that price maintenance contracts be written, and they had suggested that the failure to write such contracts would result in a refusal by them to cooperate with the company's missionary salesmen. They hinted that retailers might refuse to give display space to the company's products and even, possibly, to recommend these products to consumers. A substantial drop in the sales of Carstairs products presumably would result. Thus far, the company had not noted any effect on its sales which could be attributed to these attitudes on price maintenance. Executives were aware, however, that if the independent retailers and wholesalers became well organized, considerable pressure might be placed on the company. It was known, for instance, that organized retailers in the drug trade had succeeded in placing pressure by means of boycotts or threats of boycotts on certain manufacturers. Although such organized pressure might be a violation of state antitrust laws against horizontal combinations in restraint of trade, nevertheless no states had brought action against such organized groups; and the executives thought that such action would not be politically feasible for state law-enforcement agencies until there was a substantial consumer revolt against price maintenance.[1]

Under current circumstances without resale price control the independent retailer might do one or more of several things in meeting the competition of a price-cutting organization:

a. He might do nothing beyond answering as best he could complaints of customers about his higher price.

b. If complaint were made, he might offer to meet the competitive price in the case of the customer who complained.

c. He might meet the price generally:

1. Meet the "shelf" or usual chain or supermarket price.
2. Meet the "feature" price for its duration.

d. He might put the advertised item "under the counter," and try to sell a private brand at a competitive price.

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[1] In 1941 and 1942, Assistant U.S. Attorney General Thurman Arnold brought action against organized groups of retailers in several states, including Colorado and Massachusetts, who were alleged to be using the state unfair trade practice acts as a cloak for horizontal action to raise prices. In both Colorado and Massachusetts, drastic consent decrees resulted.

e. He might complain to the wholesaler, to the manufacturer, and to the retailers' trade association headquarters that such "loss leader" sales were unfair competition and that if corrective action were not taken he would not interest himself in making sales of the product to consumers, but would promote private brands.

f. Through associations, he might press for legislation intended, on one theory or another, to improve the competitive situation from his point of view.

The most frequently used attempt to discourage sales of loss leader items was to put them under the counter, that is, out of sight of the consumer, and to give prominent display to competitive brands. This course had drawbacks. It risked losing the goodwill of the consumer who wanted the advertised product and was offended at attempts to sell him something "just as good." The time and effort required to make a substitute sale, in busy hours, could be employed more profitably in serving waiting customers. The impression might be created that the advertised brand was not carried by the retailer and hence that his store was a less desirable place in which to trade than were other stores.

The effectiveness of the retailer's attempts at substitution was believed to depend largely on the degree of confidence that his customers had in him, the skill and diplomacy which he and his clerks showed in dealing with customers, the strength of the "franchise" of the advertised brand, the relative merit of the competitive brand, and the extent of the differential in retail prices between brands.

There was very little definite evidence of the attitude of voluntary chains toward price maintenance. It was believed that the retailer members would, for the most part, hold substantially the same view as the group of independent retailers, and that the jobber members of a voluntary chain group would have divers views, according to their economic beliefs and their practical competitive situations.

Price maintenance was strongly opposed by chain grocery companies and by supermarkets, which were anxious to maintain the advantageous economic position which their low costs of operation gave them. They argued that price maintenance on Carstairs products would mean higher prices and therefore a substantial increase in consumers' food costs. The vice president suggested, in his memorandum, that the strength of the so-called consumer movement might be substantially enhanced by price fixing. He

thought that both chain grocery companies and supermarkets would probably undertake retaliatory action similar to that open to independent retailers and wholesalers. In addition, the grocery chains would certainly encourage the sale of merchandise under their private brands. The price differential between merchandise under private brands and merchandise under nationally advertised brands would increase; and, since private brands would benefit, it was believed they needed a price differential of approximately 15% to 20% to be sold successfully in competition with nationally advertised merchandise. Again, such opposition would probably be effective in diminishing sales of the company's products.

The vice president in charge of sales suggested several additional arguments affecting the desirability of issuing price maintenance contracts. He thought that to some extent price served as a standard of value for the consumer. It was possible that cut prices reflected unfavorably on the reputation of the company's products. For a number of years the Carstairs Products Company had urged retailers not to sell at unduly low prices, because this practice tended to destroy the reputation of the products and in the long run to injure the company without corresponding benefit to the price cutter. The company also had urged the maintenance of no more than a fair differential between the regular price and the feature price. Fair minimum resale prices to the consumer were suggested. These prices were such as to permit wholesalers, retailers, and chain stores to realize gross margins neither unduly high nor unduly low. In extreme cases, where it became obvious over a period of time that a particular customer buying direct from the company was a seriously disturbing influence in his market, the company had removed that customer from the list of those to whom it sold direct. Any action that the company decided to take would displease some part of its existing customers.

One of the important arguments against issuing resale price maintenance contracts was the difficulty of enforcing those contracts. The Carstairs Products Company had no adequate machinery to control the prices charged by the several hundred thousand retailers who, according to estimates, carried Carstairs products. To make direct contacts with so many retail customers would be an expensive undertaking. The management realized that, in the drug industry, state fair-trade committees had been organized which undertook to assist the manufacturer in notifying retailers

of the issuance of price maintenance contracts by manufacturers. These committees to some extent assisted in policing and notified the manufacturer of violations. Even though fair-trade committees were being organized in some states by various factors in the grocery and food industry, they were not considered to be prepared to undertake the job of enforcing contracts. The vice president thought, further, that the company would be expected to make a substantial contribution to help defray the expenses of these committees if price maintenance contracts were issued.

The vice president also referred to the ease of evading contracts, which, in his opinion, might seriously hinder successful price maintenance. Price cutting could be successfully carried on not only through a direct reduction in the price of the article in question but through the offer of other merchandise with the article as a free deal or through the offer of other merchandise at a cut price with the article at a fixed price. Tactics of this sort could be adopted by both wholesalers and retailers, and the enforcement of price maintenance contracts would be difficult, if not impossible.

One of the most important considerations, in the opinion of the vice president, was the action that competing manufacturers might take. It would be very dangerous for the Carstairs Products Company to act alone in writing price maintenance agreements. The number of competing products was such that comparative price was a dominant factor in determining sales. If the price of one product was fixed, competing products for which no price maintenance contracts had been written could be sold for less and would benefit substantially in sales volume at the expense of the price-fixed product. It was believed that brand loyalty in the grocery field did not extend to the support of one product when that product cost one or two cents more than a directly competitive product.

The vice president also indicated that it would be dangerous for the Carstairs Products Company to act in cooperation with only two or three leading competitors. Even in this situation, there remained the possibility of underselling by one or more manufacturers of advertised brands who had not cooperated in writing price maintenance contracts. He suggested that the only feasible approach to the problem was for all manufacturers in the industry to act together. Such cooperation would constitute a violation of the Sherman Antitrust Act as a horizontal combination

in restraint of trade. Even if this cooperation were legal, there would still remain the competitive advantage enjoyed by private brands; and such cooperation might well constitute a violation of the Sherman Antitrust Act.

The vice president concluded his analysis with the statement that price maintenance was inadvisable. He recommended that the company maintain a neutral position in the controversy so long as possible. This procedure would lead to opposition on both sides. He thought that all competing food manufacturers would encounter the same difficulties which he had outlined and therefore would probably resist writing price maintenance contracts.

Nevertheless, there was a possibility, according to the vice president, that the executives of the grocery chains might eventually shift their attitude. Alarmed by the price competition of independent supermarkets, the growth in their number, and their advantageous position with regard to costs of operation, grocery chains might come to favor price maintenance at reasonable levels. In this connection the vice president recommended that the company consider price maintenance on the basis of the company list price plus 6%. This proposal was similar to the state laws which prohibited sales below invoice or replacement cost plus a minimum markup. The markup proposed was so low that the efficient merchant was not penalized and the inefficient merchant was not protected.

Should the Carstairs Products Company have written resale price maintenance contracts?

Appendix A

Legal Status of Resale Price Maintenance

The law on resale price maintenance has undergone considerable change since 1900. At that time it was the view of several companies and numerous individuals that vertical price maintenance contracts between manufacturers and distributors were legal. It was thought that they were not in restraint of trade and against public policy. This view, however, was upset in 1911 by the now famous case of *Dr. Miles Medical Company v. John D. Park & Sons Company.*[1] In that case a

[1] 31 S. Ct. 376.

majority of the Supreme Court held that resale price agreements were clearly in restraint of trade and a direct violation of the Sherman Antitrust Act of 1890. Later, in the case of the *Federal Trade Commission v. Beech-Nut Packing Company*,[1] the Supreme Court upheld the action of the Federal Trade Commission in issuing a cease and desist order against certain practices embodied in the resale price maintenance system used by the Beech-Nut Packing Company. Action in this case was brought under Section 5 of the Federal Trade Commission Act, which prohibited various methods of unfair competition. In other cases the Supreme Court upheld price maintenance agreements when they were effected by means of genuine agency agreements. Under these conditions the manufacturer did not pass title until the goods were sold to the ultimate purchaser. This method, which was used, for example, by the General Electric Company, required a large investment in stocks in the hands of dealers and distributors and was available only to companies with large financial resources. Dissenting opinions called attention to the inequity of a situation in which small companies could not avail themselves of methods of price control that were available to larger concerns. Both a majority and a minority of the Supreme Court at one time or another implied that the legislative bodies of the various states and the Congress could by legislative enactment establish a policy regarding resale price maintenance which would stand constitutional tests. Manufacturers, therefore, from time to time made pleas for the passage of enabling acts to permit resale price maintenance. Their pleas, however, made little impression on the legislators. Legislative bodies never accepted the argument that they ought to protect the goodwill of manufacturers a majority of whom were showing substantial net earnings each year. When, however, the lobbies of the organized retailers talked of the possible destruction of the small merchants, the politicians were more receptive to the idea of resale price maintenance.

The efforts of a few well-organized retail and wholesale trade organizations resulted in the passage of a fair trade act in California in 1931; and there was a rapid extension of similar acts thereafter, until, in 1941, 46 states had laws permitting resale price maintenance. The notable feature of most of these acts was the section which made a contract between two parties binding upon a third party not a party to the original contract. The Supreme Court of the United States sustained the California and Illinois Fair Trade Acts in the case of *Old Dearborn Distributing Co. v. Seagram-Distillers Corporation*.[2] This opinion made it legal for manufacturers to make contracts with wholesalers or retailers on an intrastate basis. Until the passage of the Miller-Tydings Act, however, it was not legal to make such contracts in interstate trade.

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[1] 42 S. Ct. 150.
[2] 57 S. Ct. 139.

Appendix B

California Fair Trade Act

An act to protect trade-mark owners, distributors and the public against injurious and uneconomic practices in the distribution of articles of standard quality under a distinguished trade-mark, brand or name.

The people of the State of California do enact as follows:

Section 1. No contract relating to the sale or resale of a commodity which bears, or the label or content [*sic*] of which bears, the trade-mark, brand, or name of the producer or owner of such commodity and which is in fair and open competition with commodities of the same general class produced by others shall be deemed in violation of any law of the State of California by reason of any of the following provisions which may be contained in such contract:

1. That the buyer will not resell such commodity except at the price stipulated by the vendor.

2. That the vendee or producer require in delivery [*sic*] to whom he may resell such commodity to agree that he will not, in turn, resell except at the price stipulated by such vendor or by such vendee.

Such provisions in any contract shall be deemed to contain or imply conditions that such commodity may be resold without reference to such agreement in the following cases:

1. In closing out the owners' stock for the purpose of discontinuing delivering [*sic*] any such commodity.

2. When the goods are damaged or deteriorated in quality, and notice is given to the public thereof.

3. By any officer acting under the orders of any court.

Sec. 1½. Willfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provision of section 1 of this act, whether the person so advertising, offering for sale or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby. (This section added by amendment in 1933.)

Sec. 2. This act shall not apply to any contract or agreement between producers or between wholesalers or between retailers as to sale or resale prices.

Sec. 3. The following terms, as used in this act, are hereby defined as follows:

"Producer" means grower, baker, maker, manufacturer or publisher.

"Commodity" means any subject of commerce.

Sec. 4. If any provision of this act is declared unconstitutional it is the intent of the Legislature that the remaining portions thereof shall not be affected but that such remaining portions remain in full force and effect.

Sec. 5. This act may be known and cited as the "Fair trade act." (Approved, 1931.)

Sec. 6. All the provisions of this act shall extend to any commodity sold through vending equipment. If [*sic*] such vending equipment bears the trade-mark, brand or name of the producer or owner of such commodity and if such commodity is in fair and open competition with commodities of the same general class produced by others. (This section added by amendment in 1937.)

Appendix C

Miller-Tydings Resale Price Maintenance Act

To amend the act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies"; approved July 2, 1890.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that Section 1 of the act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies," approved July 2, 1890, be amended to read as follows:

Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal: *Provided*, That nothing herein contained shall render illegal contracts or agreements prescribing minimum prices or other conditions for the resale of a commodity which bears, or the label or container of which bears, the trade-mark, or brand or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is made, or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition under section 5, as amended and supplemented, of the act entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," approved September 26, 1914. *Provided further*, That the preceding proviso shall not make lawful any contract or agreement, providing for the establishment or maintenance of minimum resale prices on any commodity herein involved, between manufacturers, or between producers, or between wholesalers, or between brokers, or between factors, or between retailers, or between persons, firms, or corporations in competition with each other. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed

guilty of a misdemeanor and, on conviction thereof, shall be punished by fine not exceeding $5,000 or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

4. CALIFORNIA UNFAIR PRACTICES ACT

PROHIBITION OF SALES BELOW COST

The State of California was a pioneer not only in fair trade (resale price maintenance) legislation but also in unfair trade (not selling below cost) legislation. The California Unfair Practices Act, as amended in 1937, read as follows:

Section 1. It shall be unlawful for any person, engaged in the production, manufacture, distribution or sale of any article or product of general use or consumption, with the intent to destroy the competition of any regular established dealer in such article or product, or to prevent the competition of any person, who in good faith, intends and attempts to become such dealer, to discriminate between different sections, communities or cities or portions thereof, or between different locations in such sections, communities, cities or portions thereof in this State, by selling or furnishing such article or product, at a lower price in one section, community or city, or any portion thereof, or in one location in such section, community, or city or any portion thereof, than in another; provided that nothing herein contained shall prevent differentials which make allowances for differences, if any, in the grade, quality or quantity when based and justified in the cost of manufacture, sale or delivery, or the actual cost of transportation from the point of production, if a raw product or commodity, or from the point of manufacture, if a manufactured product or commodity, or from the point of shipment to the point of destination; and provided further, that nothing herein contained shall prevent a selection of customers or a functional classification by any person of any customer as broker, jobber, wholesaler or retailer or a differential in price for any article or product as between any customers in different functional classifications. Motion picture films when licensed for exhibition to motion picture houses shall not be deemed to be an article or product under this act. Neither shall anything in this act be deemed to apply to any service, article or product for which rates are established under the jurisdiction of the Railroad Commission of the State of California and sold or furnished by any public utility corporation, or installation and repair services rendered in connection with any services, articles or products; or to any service, article or product sold or furnished by a publicly owned public utility and upon which the rates would have been established under the jurisdiction of the Railroad Commission of

the State of California if such service, article or product had been sold or furnished by a public utility corporation, or installation and repair services rendered in connection with any services, articles or products.

The inhibition of this act against locality discrimination shall embrace any scheme of special rebates, collateral contracts or any device of any nature whereby such discrimination is, in substance or fact, effected in violation of the spirit and intent of this section; provided, however, that nothing in this section shall be construed to prohibit the meeting in good faith of a competitive price. (Amended, 1937, ch. 860.)

Sec. 2. Any person who, either as director, officer or agent of any firm or corporation or as agent of any person, violating the provisions of this act, assists or aids, directly or indirectly, in such violation shall be responsible therefor equally with the person, firm or corporation for whom or which he acts.

In the prosecution of any person as officer, director or agent, it shall be sufficient to allege and prove the unlawful intent of the person, firm or corporation for whom or which he acts. (Amended, 1935, ch. 477.)

Sec. 3. It shall be unlawful for any person engaged in business within this State, to sell any article or product at less than the cost thereof to such vendor, or give away any article or product, for the purpose of injuring competitors or destroying competition, and he shall also be guilty of a misdemeanor, and on conviction thereof shall be subject to the penalties set out in section 11 of this act for any such act.

The term "cost" as used in this act as applied to production is hereby defined as including the cost of raw materials, labor and all overhead expenses of the producer; and as applied to distribution "cost" shall mean the invoice or replacement cost, whichever is lower, of the article or product to the distributor and vendor plus the cost of doing business by said distributor and vendor.

The "cost of doing business" or "overhead expense" as used in this act is defined as all costs of doing business incurred in the conduct of such business and must include without limitation the following items of expense: labor (including salaries of executives and officers), rent, interest on borrowed capital, depreciation, selling cost, maintenance of equipment, delivery costs, credit losses, all types of licenses, taxes, insurance and advertising.

The prohibitions of this act shall be deemed among the other purposes and objects of the act to also prohibit the practice of using any article or product as a "loss leader." Loss leader, as used herein, shall mean any article or product sold at less than cost as herein defined to induce, promote or encourage, the purchase of other merchandise, or which may have the tendency or capacity to mislead or deceive purchasers or prospective purchasers, or which diverts trade from or otherwise injures competitors.

The prohibitions of this section shall embrace any scheme of special rebates, collateral contracts or any device of any nature whereby a sale below cost is effected in violation of the spirit and intent of any of the provisions of this act. (Amended, 1937, ch. 860.)

Sec. 4. In establishing the cost of a given article or product to the distributor and vendor, the invoice cost of said article or product purchased at a forced, bankrupt, closeout sale, or other sale outside of the ordinary channels of trade may not be used as a basis for justifying a price lower than one based upon the replacement cost as of date of said sale of said article or product replaced through the ordinary channels of trade, unless said article or product is kept separate from goods purchased in the ordinary channels of trade and unless said article or product is advertised and sold as merchandise purchased at a forced, bankrupt, closeout sale, or by means other than through the ordinary channels of trade, and said advertising shall state the conditions under which said goods were so purchased, and the quantity of such merchandise to be sold or offered for sale.

"Ordinary channels of trade" shall mean those ordinary, regular and daily transactions in the mercantile trade whereby title to an article or product, in no way damaged or deteriorated, is transferred from one person to another, and shall not include sales of bankrupt stocks, closeout goods, dents, sales of goods bought from a business or merchant retiring from business, fire sales and sales of damaged or deteriorated goods, which damage or deterioration results from any cause whatsoever; provided that this last listing herein shall not be held to be all inclusive but as example only. (Amended, 1937, ch. 860.)

Sec. 5. In any injunction proceeding or in the prosecution of any person as officer, director or agent, it shall be sufficient to allege and prove the unlawful intent of the person, firm or corporation for whom or which he acts. Where a particular trade or industry, of which the person, firm or corporation complained against is a member, has an established cost survey for the locality and vicinity in which the offense is committed, the said cost survey shall be deemed competent evidence to be used in proving the costs of the person, firm or corporation complained against within the provisions of this act.

In all actions brought under the provisions of this act proof of one or more acts of selling or giving away any article or product below cost or at discriminatory prices, together with proof of the injurious effect of such acts, shall be presumptive evidence of the purpose or intent to injure competitors or destroy competition. (Amended, 1937, ch. 860.)

Sec. 6. The provisions of sections 1, 3, 4 and 5 shall not apply to any sale made:

(a) In closing out in good faith the owner's stock or any part thereof for the purpose of discontinuing his trade in any such article or product and in the case of the sale of seasonal goods or to the bona fide sale of perishable goods to prevent loss to the vendor by spoilage or depreciation, provided notice is given to the public thereof;

(b) When the goods are damaged or deteriorated in quality, and notice is given to the public thereof;

(c) By an officer acting under the orders of any court;

(d) In an endeavor made in good faith to meet the legal prices of a competitor as herein defined selling the same article or product, in the same locality or trade area and in the ordinary channels of trade as herein defined; or in an endeavor made in good faith by a manufacturer, selling an article or product of his own manufacture, in a transaction and sale to a wholesaler or retailer for resale to meet the legal prices of a competitor selling the same or a similar or comparable article or product, in the same locality or trade area and in the ordinary channels of trade as herein defined.

Any person who performs work upon, renovates, alters or improves any personal property belonging to another person, shall be construed to be a vendor within the meaning of this act. (Amended, 1937, ch. 860.)

Sec. 7. The secret payment or allowance of rebates, refunds, commissions, or unearned discounts, whether in the form of money or otherwise, or secretly extending to certain purchasers special services or privileges not extended to all purchasers purchasing upon like terms and conditions, to the injury of a competitor and where such payment or allowance tends to destroy competition, is an unfair trade practice and any person, firm, partnership, corporation, or association resorting to such trade practice shall be deemed guilty of a misdemeanor and on conviction thereof shall be subject to the penalties set out in section 11 of this act. (Amended, 1935, ch. 477.)

Sec. 8. (Repealed, 1937, ch. 860.)

Sec. 9. Any contract, express or implied, made by any person, firm, or corporation in violation of any of the provisions of sections 1 to 7, inclusive, of this act is declared to be an illegal contract and no recovery thereon shall be had. (Added, 1935, ch. 477.)

Sec. 10. Any person, firm, private corporation or municipal or other public corporation, or trade association, may maintain an action to enjoin a continuance of any act or acts in violation of any of the provisions of sections 1 to 7, inclusive, of this act and, if injured thereby, for the recovery of damages. If, in such action, the court shall find that the defendant is violating or has violated any of the provisions of sections 1 to 7, inclusive, of this act, it shall enjoin the defendant from a continuance thereof. It shall not be necessary that actual damages to the plaintiff be alleged or proved. In addition to such injunctive relief, the plaintiff in said action shall be entitled to recover from the defendant the amount of the actual damages, if any, sustained by him.

Any defendant, or any witness, in an action brought under the provisions of this section may be required to testify under the provisions of sections 2021, 2031 and 2055 of the Code of Civil Procedure of this State, in addition the books and records of any such defendant, or of any such witness, may be brought into court and introduced, by

reference, into evidence; provided, however, that no information so obtained may be used against such defendant, or any such witness, as a basis for a misdemeanor prosecution under the provisions of sections 1 to 7, inclusive, and 11 of this act. (Amended, 1937, ch. 860.)

Sec. 11. Any person, whether as principal, agent, officer or director, for himself, or for another person, or for any firm or corporation, or any corporation, who or which shall violate any of the provisions of sections 1 to 7, inclusive, of this act is guilty of a misdemeanor for each single violation and upon conviction thereof, shall be punished by a fine of not less than one hundred dollars ($100) nor more than one thousand dollars ($1,000), or by imprisonment not exceeding six months or by both said fine and imprisonment, in the discretion of the court.

Proof of average overall cost of doing business for any particular inventory period when added to the cost of production of each article or product, as to a producer, or invoice or replacement cost, whichever is lower, of each article or product, as to a distributor, shall be presumptive evidence of cost as to each such article or product involved in any action brought under this act and involving the violation of any provisions of sections 3 and 5 of this act.

Proof of transportation tariffs when fixed and approved by the Railroad Commission of the State of California shall be presumptive evidence of delivery cost as provided in section 3 hereof. (Amended, 1937, ch. 860.)

Sec. 12. If any section, sentence, clause or phrase of this act is for any reason held to be unconstitutional, such decision shall not affect the validity of the remaining portions of the act. The Legislature hereby declares that it would have passed this act, and each section, sentence, clause or phrase thereof, irrespective of the fact that any one or more sections, sentences, clauses or phrases be declared unconstitutional. (Amended, 1937, ch. 860.)

Sec. 13. The Legislature declares that the purpose of this act is to safeguard the public against the creation or perpetuation of monopolies and to foster and encourage competition, by prohibiting unfair, dishonest, deceptive, destructive, fraudulent and discriminatory practices by which fair and honest competition is destroyed or prevented. This act shall be liberally construed that its beneficial purposes may be subserved. (Amended, 1937, ch. 860.)

Sec. 14. This act shall be known and designated as the "Unfair Practices Act." (Added, 1935, ch. 477.)

Sec. 15. In any action brought under the provisions of section 3 hereof where it is alleged and shown that the person complained against is selling, below his cost of doing business, and said person is including labor at less than the prevailing wage scale in the trade in which such person is engaged for the locality or vicinity in which he is doing business, evidence of such prevailing wage scale shall be admissible to prove the intent or purpose of such person to violate the provisions of this act.

In any action brought under the provision of this act, where persons are employed or performing services without compensation for any person charged with a violation of this act, such services shall be charged as an expense of the business in which rendered and at the rate of the wage for the services rendered prevailing at the time of the service at the place where rendered. (Repealed and added, 1937, ch. 860.)

Sec. 16. As used in this act, the term "person" includes any person, firm, association, organization, partnership, business trust, company, corporation or municipal or other public corporation; the term "sell" includes selling, offering for sale or advertising for sale; the term "give" includes giving, offering to give or advertising the intent to give; the term "article or product" includes any article, product, commodity, thing of value, service or output of a service trade. (Added, 1937, ch. 860.)

Sec. 17. Solicitation by, or collusion or joint participation between any wholesaler, manufacturer, distributor, jobber, contractor, broker, or retailer to violate any of the provisions of this act or the use of any threat, intimidation or boycott to effectuate the violation of the act shall make all persons participating in such solicitation, collusion or joint participation subject to the provisions of this act, and such solicitation, collusion or joint participation shall constitute a misdemeanor. (Added, 1937, ch. 860.)

5. NATIONAL RETAIL DRY GOODS ASSOCIATION

RETAIL PRICE CONTROL

In January, 1942, the board of directors of the National Retail Dry Goods Association, which included in its membership the principal department stores of the United States, appointed a War Service Committee to consider and act on the many emergency problems which it was quite apparent would continuously arise. One of the first problems presented to the committee was that of retail price control in the event that such control was deemed necessary by the OPA.

The committee reviewed briefly the experience of the United States in the First World War. This experience was compactly set forth in the following excerpt from *Wartime Control of Prices:*[1]

The most important positive contributions of the World War experience may be summarized as follows:

[1] By Charles O. Hardy (Washington, The Brookings Institution, 1940), pp. 209–212.

1. The most important step in the process of price control was the centralization of the buying operations of the various governmental purchasing agencies, the Allies, the Railroad Administration, and various ancillary organizations, such as the Red Cross. This centralization in some cases took the form of joint buying agencies, as in wheat, and in other cases the establishment by a centralized body of a maximum price which any agency was allowed to pay, as in copper. While centralization was far from complete, it did eliminate a prime source of abnormal price increase at certain points where the problem was very serious.

2. The experience of the War Industries Board and the Price-Fixing Committee showed that substantial results can be obtained in dealing with industries where the number of producing units is small, by means of negotiation between trade association representatives and the government agency. Even in the case of southern pine lumber, where the number of units was large, substantial results were obtained in this way.

3. The experience of the Food Administration showed that effective control could be exercised through the use of a licensing system even when the number of units was large.

4. Experience under the guarantee of a minimum price for wheat and pork products showed that this is an effective means of stimulating increased output in industries where the number of units is too large for either direct negotiation with individual producers or effective control through trade associations.

5. The experience of the World War points to the conclusion that direct control of prices is an appropriate means of dealing with individual cases of acute shortage, but it does not afford support for the idea that it is practicable in this way to check a general upward movement of prices which is supported by an inflationary fiscal policy and a passive policy of credit control.

The principal shortcomings of the wartime program may be summarized as follows:

1. Although the taxes imposed during the war were heavier than those of most warring countries, there was no serious effort to insure that the funds which were borrowed by the government should represent savings from current income rather than the proceeds of bank credit expansion. On the contrary, the public was exhorted to "borrow and buy." Suggestions on the part of the Federal Reserve Board for restricting the use of newly created bank credit to support the Liberty Loan campaigns were inhibited by Treasury protests backed by the threat of drastic action. In consequence there was a steady expansion of the volume of money and bank deposits and of the flow of funds through the channels of trade. The money income of the community continued to increase after the output of goods and services had reached its peak, and the price level advanced steadily.

2. Control was applied late, and some agencies responsible for control, notably the War Industries Board and the Price-Fixing Committee, were given inadequate legal powers. Price decisions for

which there were no legal sanctions were enforced by the threat of commandeering on requisition, and their effectiveness, especially in the first six months of control, depended to a considerable extent on the practicability of utilizing such indirect sanctions in a given industry.

3. The responsibility for direct price control was divided among a number of agencies and there was little provision for co-ordinating their policies.

4. The range of control over prices paid by the government was too narrow. Except in rare instances, no central agency reviewed the contracts for unstandardized goods and services made by various government agencies. The work of the Price-Fixing Committee was confined almost entirely to raw materials and half-finished products.

5. The range of control over civilian prices exercised by the Food Administration was unnecessarily broad, extending to many goods and services for which there was no reason to believe that unjustifiably high prices should be obtained in wartime any more than in peacetime.

6. The principles of price determination that were followed were faulty in some respects. In particular there were too many cases in which the costs of a few high-cost producers were used to establish the price paid by the government to an entire industry.

7. There was undue reliance on the excess profits tax to correct unnecessarily high prices paid by the government.

In summary, it may be said that in its use of direct controls the government's policy was basically sound and that, in view of the difficult conditions under which it was applied, it was reasonably effective. There was, however, almost a complete failure to recognize the bearing of fiscal policy upon the price problem, and there was no co-operation between Treasury and Federal Reserve authorities and the agencies concerned with the direct control of prices.

The committee also sought information on British and German wartime price control. A general description of the methods in both countries was available in an article by Herbert H. B. Israel (formerly manager of the N. Israel Department Store, Berlin), from which the following excerpts are drawn:[1]

Germany started price control as far back as 1934, when the rearmament program was got under way; England introduced it as a wartime measure by the end of 1939. . . .

. . . .

According to both systems, prices existing at a certain date or period are considered to be normal, and increases over and above the prices of this basic date or period are only permissible inside of certain limits. These limits are very narrow in the German legislation, while the English regulations give more freedom of movement, but both only

[1] *Women's Wear Daily*, March 4, 1941, p. 31.

allow increases in price that can be justified by actual increases in the cost of goods and in certain items.[1] Both types of price control require a complete departure from the established percentage method of pricing as it exists in the retail field. The calculation of the selling price must be based on a money margin and not on a per cent margin. In the case of branded goods, a machinery for having fixed prices approved by a control board exists in both countries.

The German system hinges upon the limitation of the margin of markup in money to the "basic" amount; the English system limits the net profit to the prewar amount. For a better understanding of both methods, let us see how each of them works in practice:

The German method: All invoices of the "key" date or basic period (and if necessary prior to it) must be kept on record, and the cost and selling prices and especially the margin between the two are the basis of the new prices of goods. For example: Men's shirts were invoiced to a retailer during the "key" period for RM 5.00 ($1 is approximately equal to RM 2.50), and a selling price of RM 7.50 was marked on the invoice (or tab or apron); the markup margin is therefore RM 2.50. If a new consignment of the same shirts is delivered at a cost price of RM 6.00, these may not be priced at RM 9.00, *i.e.*, with a markup of 33⅓ per cent on retail as originally, but only the previous money margin of RM 2.50 may be added to the new cost price; the new selling price is therefore RM 8.50 (6 plus 2.50). The authorities reasoned that with the same volume of business the total markup margin would remain unchanged in amount, even though it would become lower in percentage. An increase in transportation costs could also be added to the selling price, as it was considered an unavoidable increased cost of doing business. If the increase worked out at RM 0.05 per shirt, then the selling price of above example would be RM 8.55 (6 plus 0.05 plus 2.50).

One of the main difficulties of the system consists in having to link up the article with the identical one stocked at the "key" date, or finding a comparable article to base the new selling price on. This necessitates keeping a file of all items carried and listing the "key" date price and all following prices. To figure and record the retail price an apron has been used which is attached to the supplier's invoice. . . .

. . . .

The apron is later detached and kept as a record in case of an investigation. For this purpose specially trained price control officials check the prices and see if the regulations are being carried out properly; this happens especially if a complaint has been made about an undue increase in price, which is generally difficult for a member of the public

[1] The English Prices of Goods Act of November 16, 1939, is officially described as follows: An act to prevent the price of goods of such descriptions as may be specified by the Board of Trade being raised above a basic price for goods by more than an amount referable to increases in certain specified expenses, and for purposes consequential thereon and incidental thereto.

to judge. The object of these investigations is mainly psychological; it has a restraining effect on the would-be "profiteer" and gives the buying public a safety valve to "let off steam."

The figuring of the new price becomes a little more complicated if the newly bought goods had not been stocked at the time of the "key" date period. At first it was left to the buyer to compare the new goods with a similar item carried at the "key" period, or he could ask the supplier to give him a letter stating what the cost price for retailers was at the time of the "key" date. Later it was made compulsory for the suppliers to give this information. For style goods the comparison could not be made as rigid as for staple goods.

What actually happens in practice when a buyer buys a new line of shirts, to keep to our example, is the following: The supplier states that the price of the shirt that he is now invoicing at RM 6.30 was RM 5.20 at the "key" period. The purchaser looks up his records and finds that the nearest type of shirt that he carried at the "key" period was the one that cost him RM 5.00. This he sold at RM 7.50 or with a 50 per cent markup on cost. Now, he assumes that if he had carried the new line of shirts at that time, he would also have added a 50 per cent markup, so that he would have sold it at RM 7.80 (5.20 plus 2.60). This markup margin of RM 2.60 is the amount that the purchaser may add to the new cost price; the new line of shirts may therefore be sold for RM 8.90 (6.30 plus 2.60).

. . . .

Price control in England is similar in its effects on retail prices, but differs to a certain extent in the manner it is applied. The main postulate in the so-called "Prices of Goods Act" is that the cash net profit pre-war and present remains the same for each item. So the trader is entitled to recoup himself with regard to:

1. The actual cost of goods.
2. All losses by way of reductions (markdowns, staff discounts, etc.).
3. Expenses.
4. The same amount (not percentage) of net profit as was made in the pre-war period.

The English regulations allow the trader to figure his expense in relation to the anticipated sales for the forthcoming period. But as the computing of the new price according to the English regulations is in practice more complicated than according to the German ones, . . . a short-cut method was worked out. . . . Tables of sliding scales were permitted to be used, which show how the markup in per cent is affected by a certain percentage increase in price. . . .

A table has to be prepared for every department, and if the markup varies widely in one department for individual markup groups, showing the maximum markup permitted under the act for various increases in the cost price of goods over and above the basic price of the "key" date.

With regard to lines which had not been carried at the "key" date period, the supplier is also in England expected to supply the data. The following table . . . shows a practical example of the method. In this case, owing to the increase of the expense ratio (caused by an anticipated decrease in sales) the markup remains higher than pre-war, even if the cost price rises by 100 per cent. The German regulations did not permit this. . . .

The following basic figures are for a comparative period. (As basis for comparison a previous season or full year can be used.)

	In dollars	In % of cost of goods
1. Cost of goods sold	10,809	
2. Gross profit	4,581	
3. Sales	15,390	
4. Expenses	3,396	31.43
5. Reductions	929	8.60
6. Net profit	1,185	19.97
7. Pre-war markup	......	51.00
8. The increase in expenses for the coming six months' period	......	9.27
9. The new basic markup	......	60.27

From this last figure, the maximum permitted markup on cost and on retail can be derived, as follows:

If the cost of goods rises by:	The maximum permitted markup is:	
	% on cost	% on retail
0% (basic markup)	60.27	37.60
10%	59.27	37.25
20%	58.44	36.90
25%	58.08	36.75
33⅓%	57.53	36.55
40%	57.14	36.40
50%	56.61	36.20
66⅔%	55.88	35.85
75%	55.57	35.75
100%	54.79	35.43

As will be seen from the above example, there are three known and easily ascertainable elements of the new selling price, namely:

1. Cost of goods
2. Reductions
3. Expenses

of which the latter two can be expressed as a constant percentage of the cost of goods. The net profit is the only figure which cannot be expressed as a fixed percentage, as the trader is not permitted under the act to make any increased net profit simply because the cost of his goods has gone up. It is, however, possible to comply with the regulations by reducing the pre-war percentage of net profit in inverse ratio to the increased price of the goods.

In Canada quite a different program of price control was adopted. There the decision was in favor of an over-all price control with special emphasis on the necessity of maintaining all retail prices unchanged. The Canadian system was described in an article by H. I. Kleinhaus (Manager of the Controllers' Congress of the National Retail Dry Goods Association), from which the following excerpts are taken:[1]

On October 18, 1941, the Canadian Prime Minister proclaimed the imposition of a general price ceiling.

. . . .

The adoption of a general price ceiling to apply to all prices—wholesale, retail, raw materials and finished goods (a few exceptions were announced later) was due to the belief that this procedure could be applied more quickly than any other with a similar objective; that to impose a ceiling on all prices simultaneously was more equitable than to cover some products immediately and others later (because the selling prices of one become the costs of another); that the administrative problems of dealing with separate prices in turn were greater than those connected with a general price ceiling; and finally because a general price ceiling starting with an actual relationship of prices was a more realistic method of price control than one requiring the building up of an arbitrary scale of maximum prices.

The period Sept. 15 to Oct. 11 was designated as the Base Period. Under the order of the Wartime Prices and Trade Board, the effective date as first announced was Nov. 17; later this was amended to Dec. 1st. . . . Under the regulations the highest price under which a seller sold goods or services during the base period constitutes the (his) ceiling price, above which he may not sell after the effective date.

The sanctity of the retail ceiling is so great that such phrases as "the ceiling must not be pierced" and "the prices paid by consumers must not rise" occur again and again in the various orders and press releases of the Board.

. . . .

The operation of the price control system starts with the consumer. . . . The Board has used newspapers and radio to explain

[1] *Women's Wear Daily*, December 22, 1941, p. 18.

the objective and to enlist the public in the work of enforcement. Watchfulness on the part of the consumer, together with the pressure of the retailer (who may be caught between his price ceiling and the need for an adequate margin), it is believed, will be strong enough factors to keep wholesale prices within their ceilings and in fact lower them. When such reductions, which a retailer feels he must have, are not forthcoming, the retailer may call on the Board to procure him relief.

The Board on being satisfied that the retailer needs help will, and can under its broad powers, cause the supplier to give the relief. In many cases doubtless the retailer and the supplier may be required to share the "squeeze" brought about by the retail ceiling. In some instances the supplier will turn to his raw material resource for aid. The latter then may be ordered to give a price reduction—thus absorbing his own "squeeze" or may be subsidized in whole or in part by the government through the Commodity Prices Stabilization Corporation.

. . . .

Retailers and others are not permitted to lower quality, workmanship, size, weight or intrinsic value. Moreover, the ceiling applies not only to similar goods but to those substantially like those carried during the base period. In all cases the burden of establishing what was the maximum price on an article during the base period is placed on the retailer.

In the case of new goods, the retailer's prices must be "proportionate" to the prices of goods having some relationship to the goods in question. This brings in the factor of markup as well. Furthermore, the Board announced that it would in some cases issue maximum prices based on cost, and actually has prepared a list of maximum retail prices of spring dresses as related to manufacturers' selling prices.

. . . .

The Board anticipates that the squeeze which some sellers will be forced to take will require or encourage them to reduce the quality and type of service rendered. Far from prohibiting such action, the Board, in its announcements, speaks of the increasing importance of the necessity for economies in production and distribution.

. . . .

The importance of labor costs as a component of the price structure has been definitely recognized under the price control system.

Wages and wage rates for those of the staff including rank of foreman or comparable rank have been frozen as of Nov. 15th. However, such employees must be paid a cost of living bonus beginning Feb. 15th. This bonus is to be calculated on the rise, if any, in the national cost of living index figure between Oct. 1st and Jan. 1st, as follows:

1. To adult male employees and all others receiving $25.00 or more per week, 25 cents per week for each full point rise in the index.

2. To male employees under 21 years of age and to females receiving less than $25.00 per week, 1% of their salary rate for each full point rise.

After studying these various price control programs the War Service Committee of the NRDGA was of the opinion that there was no immediate need for a general retail price control in the United States. The committee considered that the plan of piecemeal price control was working fairly effectively in the United States. Beginning with a price ceiling on secondhand machine tools in February, 1941, the various Washington agencies of price administration had formally established more than 60 price ceilings by the end of 1941 and had secured the voluntary agreement of businessmen in various industries to price ceilings on approximately 70 other lines. The belief of the committee that this type of price control was proving effective was supported by the following comparison of price movements in the First World War and the Second World War:

. . . .

U.S. Bureau of Labor Statistics Wholesale Price Index, by Groups of Commodities, for Selected Months during the First and Second World Wars
(1926 = 100)

Commodity Group	First World War			Second World War		
	July, 1914	May, 1917	Percentage Gain	July, 1939	January, 1942	Percentage Gain
All Commodities	67.6	120.7	79%	75.4	96.0	27%
Farm Products	71.4	133.4	87	62.6	100.8	61
Foods	62.9	108.6	73	67.5	93.7	39
Hides and Leather Products	69.7	126.6	82	92.5	114.9	24
Textile Products	55.3	91.5	65	67.6	93.6	38
Fuel and Lighting Materials	55.7	113.4	104	72.8	78.2	7
Metals and Metal Products	79.1	155.1	96	93.2	103.5	11
Building Materials	52.9	89.9	70	89.7	109.3	22
Chemicals and Allied Products	77.9	160.4	106	75.0	96.0	28
Housefurnishing Goods	56.7	71.0	25	85.6	102.4	20
Raw Materials	67.3	128.5	91	67.8	96.1	42
Semimanufactured Articles	67.8	154.1	127	74.4	91.7	23
Manufactured Products	66.9	110.5	65	79.2	96.4	22
All Commodities Other than Farm Products and Foods	65.7	116.3	77	80.2	94.6	18

Source: U.S. Bureau of Labor Statistics *Wholesale Prices* (Washington, Government Printing Office), published monthly.

Nevertheless, recognizing that growing scarcities of civilian goods would inevitably necessitate the extension of some price controls to the retail level, the War Service Committee of the NRDGA in collaboration with the Retailers' Advisory Council and the American Retail Federation, in February, 1942, drafted a plan for the application of a selective retail price control on scarce items during the war. The principal feature of this plan was the provision for recognizing the lags between manufacturing and wholesale prices and between wholesale and retail prices. Statistics were offered purporting to show that the lag between retail and wholesale prices as of November 15, 1941, amounted to 10.6%.

As of early April, 1942, retail price controls were beginning to be invoked for a number of scarce items. For instance, the retail prices of 44 common electrical household appliances, including bread toasters, broilers, chafing dishes, cigarette lighters, curling irons, dry shavers, hair clippers, juice extractors, trouser pressers, percolators, waffle irons, and so on, were ordered frozen by the OPA at levels no higher than those in effect on March 30, 1942.

At the same time, strong rumors were in circulation to the effect that the OPA, convinced that the piecemeal price control program was not going to prove adequate, was about to establish a general over-all price ceiling along the lines of the Canadian plan.

This was the situation when the board of directors of the NRDGA met on April 8, 1942.

What recommendations, if any, should the Board have made to the OPA?

Appendix

On April 28, 1942, the OPA issued the following General Maximum Price Regulation, Bulletin No. 1:

FINDINGS OF THE PRICE ADMINISTRATOR

"In the judgment of the Price Administrator the prices of commodities and services generally have risen and are threatening further to rise to an extent and in a manner inconsistent with the purposes of the Emergency Price Control Act of 1942.

"In the judgment of the Price Administrator the maximum prices established by this regulation, which apply with certain exceptions

to all commodities and services not otherwise subject to regulation, are generally fair and equitable and are necessary to check inflation and to effectuate the purposes of the Act.

"So far as practicable the Price Administrator gave due consideration to prices prevailing between October 1 and 15, 1941, and to relevant factors of general applicability. So far as practicable the Price Administrator consulted with representatives of trade and industry.

"A statement of the considerations involved in the issuance of this Regulation is issued simultaneously herewith.

"Therefore, under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, this General Maximum Price Regulation is hereby issued.

MAXIMUM PRICES

"NOTE: The meaning of certain provisions and terms of this Regulation is further explained and defined in Section 20. The explanations and definitions are set forth in alphabetical order. The terms explained and defined are italicized the first time they appear in the text.

Section 1.—Prohibition Against Dealing in Commodities or Services Above Maximum Prices.

"On and after the effective date of this Regulation, regardless of any contract or other obligation:

"(*a*) No *person* shall *sell* or deliver any *commodity*, and no person shall sell or supply any *service*, at a price higher than the maximum price permitted by this Regulation; and

"(*b*) No person in the course of trade or business shall buy or receive any commodity or service at a price higher than the maximum price permitted by this Regulation.

Section 2.—Maximum Prices for Commodities and Services: General Provisions.

"Except as otherwise provided in this Regulation, the *seller's* maximum price for any commodity or service shall be:

"(*a*) In those cases in which the seller dealt in the same or similar commodities or services during March, 1942:

"The highest price charged by the seller during such month—

"(1) For the same commodity or service; or

"(2) If no charge was made for the same commodity or service, for the similar commodity or service most nearly like it; or

"(*b*) In those cases in which the seller did not deal in the same or similar commodities or services during March, 1942:

"The highest price charged during such month by the *most closely competitive seller of the same class*—

"(1) For the same commodity or service; or

"(2) If no charge was made for the same commodity or service, for the similar commodity or service most nearly like it.

HIGHEST PRICE CHARGED DURING MARCH, 1942

"For the purposes of this Regulation, the highest price charged by a seller 'during March, 1942' shall be:

"(1) The highest price which the seller charged for a commodity *delivered* or service *supplied* by him during March, 1942; or

"(2) If the seller made no such delivery or supplied no such service during March, 1942, his highest *offering price* for delivery or supply during that month.

No seller shall change his customary allowances, discounts or other price differentials unless such change results in a lower price. The 'highest price charged' shall be a price charged during March, 1942, to a *purchaser of the same class.* But if during March, 1942, a seller (*a*) had an established practice of making allowances, discounts or price differentials to different classes of purchasers, and (*b*) raised his general level of prices, but thereafter during March, 1942, made no delivery to any purchaser of a particular class, he shall, for that particular class of purchasers calculate the highest price charged by taking the highest price charged during March, 1942, to a purchaser of another class and then adjusting such price to reflect his established allowances, discounts and price differentials. No seller shall require any purchaser, and no purchaser shall be permitted, to pay a larger proportion of transportation costs incurred in the delivery or supply of any commodity or service, than the seller required purchasers of the same class to pay during March, 1942, on deliveries or supplies of the same or similar types of commodities or services.

SIMILAR COMMODITIES OR SERVICES

"One commodity shall be deemed 'similar' to another commodity, if the first has the same use as the second, affords the purchaser fairly equivalent serviceability, and belongs to a type which would ordinarily be sold in the same price line. In determining the similarity of such commodities, differences merely in style or design which do not substantially affect use, or serviceability, or the price line in which such commodities would ordinarily have been sold, shall not be taken into account. One service shall be deemed 'similar' to another service if the first has the same use and purpose as the second and belongs to a type which would ordinarily be sold for the same or substantially the same price.

Section 3.—Maximum Prices for Commodities Which Cannot Be Priced Under Section 2.

"The seller's maximum price for a commodity which cannot be priced under section 2 of this Regulation shall be a maximum price in line with the level of maximum prices established by this Regulation. Such price shall be determined by the seller in accordance with the following procedures:

"(a) Sales at wholesale or retail. In the case of a *sale at wholesale or retail*, the seller (1) shall select from the same general classification and price range as the commodity being priced under this section, the comparable commodity for which a maximum price is established under section 2 of this Regulation and of which the seller delivered the largest number of units during March, 1942; (2) shall divide his maximum price for that commodity by his *replacement cost* of that commodity; and (3) shall multiply the percentage so obtained by the cost to him of the commodity being priced under this paragraph. The resulting figure shall be the maximum price of the commodity being priced. Within ten days after determining such maximum price under this paragraph, the seller shall report such price to the *appropriate field office of the Office of Price Administration* upon a form, duly filled out and signed under oath or affirmation, copied from the form contained in Appendix A of this Regulation. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.

"(b) Sales other than at wholesale or retail. In the case of a sale other than at wholesale or retail, the maximum price shall be a price determined by the seller after specific authorization from the Office of Price Administration. A seller who seeks an authorization to determine a maximum price under the provisions of this paragraph shall file with the Office of Price Administration in Washington, D.C., an application setting forth (1) a description in detail of the commodity for which a maximum price is sought; and (2) a statement of the facts which differentiate such commodity from other commodities delivered during March, 1942, by such seller and by other competitive sellers of the same class. If such authorization is given, it will be accompanied by instructions as to the method for determining the maximum price. Within ten days after such price has been determined, the seller shall report the price to the Office of Price Administration in Washington, D.C., upon a form, duly filled out and signed under oath or affirmation, which will be furnished him. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.

Section 4.—Supplemental Regulations.

"If the maximum prices established for any commodity under the provisions of this Regulation fail equitably to distribute returns from the sale at retail of such commodity among producers, manufacturers, wholesalers and retailers, the Price Administrator will by supplementary regulation establish such maximum prices for different classes of sellers, or fix such base periods for the determination of their maximum prices, as will insure that each such class of sellers shall receive a fair share of such return.

Section 5.—Transfers of Business or Stock in Trade.

"If the business, assets or stock in trade of any business are sold or otherwise transferred after April 28, 1942, and the transferee carries on the business, or continues to deal in the same type of commodities

or services, in an establishment separate from any other establishment previously owned or operated by him, the maximum prices of the transferee shall be the same as those to which his transferor would have been subject if no such transfer had taken place, and his obligation to keep records sufficient to verify such prices shall be the same. The transferor shall either preserve and make available, or turn over, to the transferee all records of transactions prior to the transfer which are necessary to enable the transferee to comply with the record provisions of this Regulation.

Section 6.—Sales for Export.

"The maximum price at which a person may export any commodity shall be determined in accordance with the provisions of the Maximum Export Price Regulation issued by the Office of Price Administration on April 25, 1942.

Section 7.—Federal and State Taxes.

"Any tax upon the sale of a commodity or service, and any compensating use tax upon a commodity, levied by any statute of the United States or statute or ordinance of any state or subdivision thereof, shall be treated as follows in determining the seller's maximum price for such commodity or service and in preparing the record of such seller with respect thereto:

"(*a*) As to a tax in effect during March, 1942:

"(1) If the seller customarily stated and collected such tax separately from the purchase price during March, 1942, the seller shall not include the tax in determining the maximum price under this Regulation, and in such case may collect the tax in addition to the maximum price.

"(2) If the seller did not customarily state and collect such tax separately from the purchase price during March, 1942, the seller shall include the tax in determining the maximum price under this Regulation, and in such case may not collect the tax in addition to the maximum price.

"(*b*) As to a tax which becomes effective after March 31, 1942:

"If the statute or ordinance levying such tax requires or permits the seller to state and collect the tax separately from the price paid by the purchaser, and the seller does separately state it, the seller may collect the tax in addition to the maximum price.

Section 8.—Less Than Maximum Prices.

"Lower prices than those established by this Regulation may be charged, demanded, paid or offered.

COMMODITIES AND SERVICES EXCEPTED FROM THIS REGULATION

Section 9.—Commodities Excepted from This Regulation.

"(a) This Regulation shall not apply to sales or deliveries of the following commodities:

(1) Any *raw and unprocessed agricultural commodity or greenhouse commodity* while it remains in substantially its original state, except that bananas shall be governed by this Regulation.
(2) Eggs and poultry.
(3) All milk products, including butter, cheese, condensed and evaporated milk, except that fluid milk sold at retail, cream sold at retail, and ice cream shall be governed by this Regulation.
(4) Flour, except that packaged cake mixes and other packaged flour mixes shall be governed by this Regulation.
(5) Mutton and lamb.
(6) Fresh fish and seafood, and game.
(7) Dried prunes, dry edible beans, leaf tobacco (whether dried or green), nuts (but not peanuts), linseed oil, linseed cake and linseed meal, *mixed feed* for animals, and manure.
(8) Living animals, whether wild or domestic.
(9) Books, magazines, motion pictures, periodicals, newspapers, and materials furnished for publication by any press association or feature service.
(10) Domestic ores and ore concentrates.
(11) Stumpage, logs, and pulpwood.
(12) Stamps and coins; precious stones; antiques and knotted oriental rugs; paintings, etchings, sculptures and other objects of art.
(13) Used automobiles.
(14) Wood and gum for naval stores, and naval stores prior to sale to industrial consumers, or prior to the first sale to a distributor; provided, however, that this Regulation shall apply to all sales of such commodities on any exchange.
(15) *Securities.*
(16) Such other commodities as may be specified by supplementary regulations issued under this section.

"(b) This Regulation shall not apply to the following sales or deliveries:

(1) By a farmer, of commodities grown and processed on his farm, if the total of such sales or deliveries does not exceed $75 in any one calendar month.

(2) By any merchant, farmer, artisan, or person who renders professional services, of his used supplies, or business, farm, or professional equipment, not acquired or produced by him for the purpose of sale.
(3) By an owner, of his used personal or household effects or other personal property used by him.
(4) At a bona fide auction of used household or personal effects.
(5) By hotels, restaurants, soda fountains, bars, cafes, or other similar establishments, of food or beverages prepared and sold for consumption on the premises.
(6) By a breeder, trapper, or hunter, of pelts, furs, or other parts of wild animals raised by him, or trapped, shot, or killed by him, if the total of such sales or deliveries does not exceed $75 in any one calendar month.
(7) Of commodities sold without private profit in the course of any sale, fair, or bazaar conducted for a period of not more than 15 days by any religious, charitable, or philanthropic organization.
(8) To the United States or any agency thereof of such commodities or in such transactions as may be specified by supplementary regulations issued under this section.
(9) Such other sales and deliveries as may be specified by supplementary regulations issued under this section.

Section 10.—Services Excepted from this Regulation.

"The provisions of this Regulation shall not apply to the following services:
(*a*) Services of an employee to his employer.
(*b*) Personal services not rendered in connection with a commodity.
(*c*) Professional services.
(*d*) Motion pictures, theatres and other entertainments.
(*e*) Services of a common carrier or public utility.
(*f*) Advertising services, including radio broadcasting.
(*g*) Insurance and underwriting services.
(*h*) Press association and feature services.
(*i*) Services relating solely to real property.
(*j*) Such other services as may be specified by supplementary regulations issued under this section.

RECORDS

Section 11.—Base-Period Records.

"Every person selling commodities or services for which, upon sale by that person, maximum prices are established by this Regulation, shall:

"(*a*) Preserve for examination by the Office of Price Administration all his existing *records* relating to the prices which he charged for such of those commodities or services as he delivered or supplied during March, 1942, and his offering prices for delivery or supply of such commodities or services during such month; and

"(*b*) Prepare, on or before July 1, 1942, on the basis of all available information and records, and thereafter keep for examination by any person during ordinary business hours, a statement showing:

> "(1) *The highest prices which he charged for such of those commodities or services as he delivered or supplied during March, 1942, and his offering prices for delivery or supply of such commodities or services during such month, together with an appropriate description or identification of each such commodity or service; and*
>
> "(2) *All his customary allowances, discounts, and other price differentials.*

Any person, other than a person selling at retail, who claims that substantial injury would result to him from making such a statement available to any other person, may file it with the appropriate field office of the Office of Price Administration. The information contained in such statement will not be published or disclosed unless it is determined that the withholding of such information is contrary to the purposes of this Regulation.

Section 12.—Current Records.

"Every person selling commodities or services for which, upon sale by that person, maximum prices are established by this Regulation shall keep, and make available for examination by the Office of Price Administration, records of the same kind as he has customarily kept, relating to the prices which he charged for such of those commodities or services as he sold after the effective date of this Regulation; and, in addition, records showing, as precisely as possible, the basis upon which he determined maximum prices for those commodities or services.

Section 13.—Maximum Prices of Cost-of-Living Commodities: Statement, Marking or Posting.

"For the purposes of this section, a cost-of-living commodity is any commodity designated as such by the Price Administrator. A list of the classes of commodities so designated appears in Appendix B of this Regulation.

"(*a*) *On and after May 18, 1942, every person offering to sell a cost-of-living commodity at retail shall mark the maximum price of such commodity in a manner plainly visible to, and understandable by, the purchasing public. The maximum price may be marked on the commodity itself or on the shelf, bin, rack, or other holder or container upon or in which the commodity is kept, or it may be posted at the place in the business establishment where the commodity is offered for sale.* The maximum

price shall be stated as follows: 'Ceiling Price $__.__'; or 'Our Ceiling $__.__.' Any person choosing to post by price-lines the maximum prices of commodities in the classifications marked by asterisks in Appendix B, shall post the maximum price by price-line at the place in the business establishment where the commodities in such price-line are offered for sale, and, in addition, shall mark the selling price of each such commodity on the commodity itself.

"(*b*) *On or before June 1, 1942, every person offering to sell cost-of-living commodities at retail shall file with the appropriate War Price and Rationing Board of the Office of Price Administration a statement showing his maximum price for each such commodity, together with an appropriate description or identification of it. Such statement shall be kept up to date by such person by filing on the first day of every succeeding month a statement of his maximum price for any cost-of-living commodity newly offered for sale during the previous month, together with an appropriate description or identification of the commodity.*

Section 14.—Sales Slips and Receipts.

"Any seller who has customarily given a purchaser a sales slip, receipt, or similar evidence of purchase shall continue to do so. Upon request from a purchaser any seller, regardless of previous custom, shall give the purchaser a receipt showing the date, the name and address of the seller, the name of each commodity or service sold, and the price received for it.

REGISTRATION AND ENFORCEMENT

Section 15.—Registration.

"*Every person selling at wholesale, and every person who owns, or hereafter becomes the owner of, any business operating an establishment selling at retail any commodity or service for which a maximum price is established by this Regulation or by any other price regulation issued on or prior to April 28, 1942, by the Office of Price Administration shall register each such establishment with the Office of Price Administration at such time and in such manner as the Administrator may hereafter by regulation prescribe, on forms which will be made available by the Office of Price Administration.*

Section 16.—Licensing.

"Every person selling at wholesale or retail any commodity or service for which a maximum price is established by this Regulation or by any other price regulation issued on or prior to April 28, 1942, by the Office of Price Administration is by this Regulation granted a license as a condition of selling at retail any such commodity or service. Such license shall be effective on the effective date of this Regulation or when any such person becomes subject to the maximum price provisions of this or any other price regulation, and shall, unless suspended in accordance with the provisions of the Emergency Price Control Act of

1942, remain in effect as long as such regulation, or any applicable part, amendment, or supplement remains in effect.

Section 17.—Penalties.

"Persons violating any provision of this Regulation are subject to the criminal penalties, civil enforcement actions, and suits for treble damages provided for by the Emergency Price Control Act of 1942, and proceedings for the suspension of licenses.

PROCEDURE FOR ADJUSTMENT OR AMENDMENT

Section 18.—Applications for Adjustment by Retail Sellers.

"(*a*) Any seller at retail who finds that the maximum price of a commodity or service established for him under the provisions of sections 2 or 3 of this Regulation is abnormally low in relation to the maximum prices of the same or similar commodities or services established for other sellers at retail, and that this abnormality subjects him to substantial hardship, may file an application for adjustment of that maximum price in accordance with procedural regulations which will be issued by the Office of Price Administration.

"(*b*) Any seller at retail who finds that his maximum price for any commodity, and the maximum prices of other retail sellers for the same commodity are abnormally low in relation to the level of maximum prices established by this Regulation for wholesalers, manufacturers or producers of such commodity, and that this relationship subjects sellers at retail of such commodity generally to substantial hardship, should immediately communicate such information in writing to the Retail Trade and Services Division, Office of Price Administration, Washington, D.C., so that the Price Administrator may take appropriate action.

Section 19.—Petitions for Amendment.

"Any person seeking a modification of any provision of this Regulation, or an adjustment not provided for in section 18 of this Regulation, may file a petition for amendment in accordance with the provisions of Procedural Regulation No. 1 issued by the Office of Price Administration.

DEFINITIONS AND EXPLANATIONS

Section 20.—Definitions and Explanations.

"This Regulation, and the terms appearing therein, unless the context otherwise requires, shall be construed as follows:

"(*a*) *Appropriate Field Office of the Office of Price Administration.*

" 'Appropriate field office of the Office of Price Administration' means the district office for the district (or in the absence of such district office, the state office for the State) in which is located the seller's place of business from which his sales are made.

"(*b*) *Appropriate War Price and Rationing Board.*

"'Appropriate War Price and Rationing Board' means the War Price and Rationing Board for the area in which is located the seller's place of business from which the cost-of-living commodities are offered for sale.

"(*c*) *Commodity.*

"'Commodity' includes commodities, articles, products, and materials and contracts to buy, sell, or deliver any of the foregoing, but does not include real property.

"(*d*) *Delivered.*

"A commodity shall be deemed to have been 'delivered' during March, 1942, if during such month it was received by the purchaser or by any carrier, including a carrier owned or controlled by the seller, for shipment to the purchaser.

"(*e*) *Establishment Selling at Retail.*

"'Establishment' refers to the physical location of the store, shop, or other place of business in which commodities or services are sold. Any such establishment shall be deemed to be selling at retail if it has an established practice of making sales at retail.

"(*f*) *Mixed Feed.*

"'Mixed feed' includes a mixture or blend of more than one feed ingredient for the purpose of feeding animals, except a mixed feed resulting from the blending or mixing of offal from a single grain.

"(*g*) *Most Closely Competitive Seller of the Same Class.*

"'Seller of the same class' means a seller (1) performing the same function (for example, manufacturing, distributing, retailing, processing, storing, installing, or repairing), (2) of similar type (for example, department store, mail order house, chain store, specialty shop, cut-rate store), (3) dealing in the same type of commodities or services, and (4) selling to the same class of purchaser. A seller's 'most closely competitive seller of the same class' shall be a seller of the same class who (a) is selling the same or a similar commodity, and (b) is closely competitive in the sale of such commodities, and (c) is located nearest to the seller.

"(*h*) *Offering Price.*

"'Offering price' means the price quoted in the seller's price list, or, if he had no such price list, the price which he regularly quoted in any other manner, except that in the case of sales of commodities by an establishment selling at retail, the offering price shall be the price at which the commodity was offered for sale at the immediate point of sale (for example, the shelves or counters). But 'offering price' shall not include a price intended to withhold a commodity or service from the market, or a price offered as a bargaining price by a seller who usually sells at a price lower than his asking price.

"(*i*) *Person.*

"'Person' includes an individual, corporation, partnership, association, any other organized group of persons, legal successor or representative of any of the foregoing, and includes the United States, any agency

thereof, any other government, or any of its political subdivisions, and any agency of any of the foregoing.

"(*j*) *Price Regulation.*

"'Price regulation' means a price schedule effective in accordance with the provisions of Section 206 of the Emergency Price Control Act of 1942, a maximum price regulation or temporary maximum price regulation issued by the Office of Price Administration, or any order issued pursuant to any such regulation or schedule.

"(*k*) *Purchaser of the Same Class.*

"'Purchaser of the same class' refers to the practice adopted by the seller in setting different prices for commodities or services for sales to different purchasers or kinds of purchasers (for example, manufacturer, wholesaler, jobber, retailer, government agency, public institution, individual consumer) or for purchasers located in different areas or for different quantities or grades or under different conditions of sale.

"(*l*) *Raw and Unprocessed Agricultural Commodity or Greenhouse Commodity.*

"Commodities that are picked, harvested, threshed, ginned, husked, cleaned, baled, boxed, packed, transported, and/or refrigerated, without more, remain 'raw and unprocessed.' But operations such as slaughtering, freezing, drying, canning, preserving, milling, crushing, straining, centrifuging, shelling of peanuts, and purifying with heat, constitute processing for this purpose. For purposes of this Regulation, flowers, seeds, and bulbs shall be agricultural or greenhouse commodities. Forest products, such as lumber and naval stores and mineral products, whether processed or unprocessed, shall not be deemed to be agricultural commodities.

"(*m*) *Records.*

"'Records' includes books of account, sales lists, sales slips, orders, vouchers, contracts, receipts, invoices, bills of lading, and other papers and documents.

"(*n*) *Replacement Cost.*

"'Replacement cost' shall be the net price paid by the seller after May 18, 1942, or the net price which the seller would have to pay to replace such commodity after such date.

"(*o*) *Sale at Retail.*

"'Sale at retail' or 'selling at retail' means a sale or selling to an ultimate consumer other than an industrial or commercial user, except that for the purposes of section 4 of this Regulation a 'sale at retail' shall not include any sale by a producer, manufacturer, or fabricator of any commodity produced, manufactured, or fabricated by him.

"(*p*) *Sale at Wholesale.*

"'Sale at wholesale' means a sale by a person who receives delivery of a commodity and resells it, without substantially changing its form, to any person other than the ultimate consumer.

"(*q*) *Securities.*

"'Securities' includes any note, stock, bond, and interest or instrument commonly known as a 'security.'

"(*r*) *Sell.*

"'Sell' includes sell, supply, dispose, barter, exchange, lease, transfer, and deliver, and contracts and offers to do any of the foregoing. The terms 'sale,' 'selling,' 'sold,' 'seller,' 'buy,' 'purchase' and 'purchaser,' shall be construed accordingly. Nothing in this Regulation shall be construed to prohibit the making of a contract to sell a commodity or service at a price not to exceed the maximum price at the time of delivery or supply.

"(*s*) *Seller.*

"'Seller' includes a seller of any commodity or service. Where a seller makes sales or supplies services through more than one selling unit, other than salesmen making sales at uniform prices, each separate place of business of the seller shall be deemed to be a separate seller, except that for the purposes of section 16 of this Regulation, the owner of the business shall be considered the seller regardless of the number of separate places of business he owns.

"(*t*) *Service.*

"'Service' includes any service rendered or supplied, otherwise than as an employee, in connection with the processing, distribution, storage, installation, repair, or negotiation of purchase or sale of a commodity, and generally, without limiting the foregoing, all services which preserve or add to the value or utility of a commodity.

"(*u*) *Supplied.*

"A service shall be deemed to have been 'supplied' during March, 1942, if during such month it was completed or in process.

OTHER PRICE REGULATIONS, APPLICABILITY, EFFECTIVE DATE

Section 21.—Effect of Other Price Regulations.

"This Regulation shall not apply to any sale or delivery for which a maximum price is in effect, at the time of such sale or delivery, under the provisions of any other price regulation issued, or which may be issued, by the Office of Price Administration.

Section 22.—Applicability.

"The provisions of this Regulation shall be applicable to the United States, its territories and possessions, and the District of Columbia.

Section 23.—Effective Date.

"All the provisions of this Regulation shall become effective on May 11, 1942, except that:

"(*a*) The provisions of this Regulation, other than Section 11 (*a*), shall not apply to establishments selling at retail until May 18, 1942;

"(*b*) The provisions of Sections 1 and 2 shall not apply to any sale of services at retail until July 1, 1942; and

"(*c*) The provisions of Section 11 (*a*) shall become effective upon the date of issuance of this Regulation.

"Issued this 28th day of April 1942.

LEON HENDERSON
Price Administrator

APPENDIX A

GENERAL MAXIMUM PRICE REGULATION
REPORT OF MAXIMUM PRICE DETERMINED UNDER SECTION 3 (a)

"To: Office of Price Administration

"From:..
Name

....
Address

"The undersigned hereby reports its determination, made in accordance with Section 3 (*a*) of the General Maximum Price Regulation, of the maximum price for the commodity described in item 1 below.

"1. Brief description of commodity for which a maximum price is reported:...

....

"2. Reasons why price could not be determined on the basis of a same or similar commodity dealt in by the undersigned or a competitive seller during March, 1942:..

....

"3. (*a*) General classification in which the undersigned classes the commodity for which maximum price is reported.................

(*b*) Name of comparable commodity in this general classification and price range of which the undersigned delivered the largest number of units during March, 1942 (referred to herein as 'comparable commodity')..

"4. The maximum price reported was determined from calculations A, B, and C below, in accordance with instructions printed in Appendix A of the General Maximum Price Regulation:

A. Comparable Commodity:

Col. (1)	Col. (2)	Col. (3)	Col. (4)	Col. (5)
Name	Unit of pricing	Replacement cost per unit	Maximum price per unit	Percentage (col. 4 divided by col. 3)
Example: Commodity X..	Each	$4.00	$5.00	125

B. Cost per unit of commodity for which maximum price is reported...

C. Maximum price reported per unit................................

(Item 4B multiplied by percentage, Item 4A, Col. 5)

"I swear (or affirm) that to the best of my knowledge and belief, the above statements are true.

....
Sign

....
Address

INSTRUCTIONS

"Section 3 (*a*) of the General Maximum Price Regulation provides for the determination of a maximum price by a seller for commodities which cannot be priced under the provisions of Section 2. Any seller who has determined a maximum price under Section 3 (a) is required, within 10 days after such determination, to report such price to the appropriate field office of the Office of Price Administration.

"The following instructions must be followed in completing this form:

"Item 1.—Name the commodity for which the price is reported; indicate its use, unit, size, package, etc.

"Item 2.—Indicate how commodity for which price is reported differs from other commodities sold by seller, or competitive sellers of the same class, during March, 1942.

"Item 3.—(*a*) Insert general classification (food, hardware, clothing, etc.), in which the seller classes the commodity for which a maximum price is reported.

"(*b*) Insert the name of comparable commodity in the same general classification and price range of which the seller delivered the largest number of units during March, 1942.

"Item 4-A.—Column 1.—Name of comparable commodity.

Column 2.—Insert unit of pricing, *e.g.*, pound, quart, garment, etc.

Column 3.—Insert replacement cost per unit. Replacement cost shall be *net price*[1] per unit paid by the seller after May 18, 1942, or the net price which the seller would have to pay to replace the comparable commodity after such date.

Column 4.—Insert the maximum price per unit established in accordance with Section 2 of General Maximum Price Regulation.

"Item 4-B.—Insert *net cost*[1] per unit of commodity for which price is reported.

"Item 4-C.—Calculate maximum price reported per unit as follows: Multiply unit cost (4-B) by percentage (4-A, Column 5)."

[Appendix B listed the commodities designated by the Price Administrator as Cost-of-Living Commodities. These were grouped under the following major headings:

Tobacco, Drugs, Toiletries, and Sundries
Apparel and Yard Goods
Food and Household Sundries
Household Furniture, Appliances, and Furnishings
Hardware, Agricultural Supplies, Miscellaneous
Ice, Fuel, and Automotive.]

[1] " 'Net price' (or 'net cost') shall be the price paid after deducting all discounts allowed to, and adding transportation and delivery charges paid by, the seller."

On May 12, 1942, Maximum Price Regulation No. 142 was issued, covering the determination of ceiling prices for certain summer seasonal goods. This Regulation read in part as follows:

"§1372.2. Maximum Prices for Sales of Seasonal Commodities at Retail. (*a*) Except as otherwise provided in Section 1372.3, the maximum price for a sale at retail of any commodity designated as a seasonal commodity in paragraph (*b*) of this section shall be (1) the seller's average cost of the commodity being priced, or (2) the net price which the seller would have to pay to replace such commodity after May 11, 1942, whichever is lower, plus the average percentage markup taken by the seller on the same seasonal commodity sold during his last selling season, or, if the seller is unable to establish such markup on such seasonal commodity, the average markup in the department in which the same seasonal commodity, or similar commodities, were sold during his last selling season. The seller's average cost of any commodity shall be his average cost on purchases of such commodity made between the close of his last selling season and (1) the opening of his 1942 selling season or (2) May 11, 1942, whichever is later.

. . . .

"§1372.3. Relationship between Maximum Price Regulation No. 142 and the General Maximum Price Regulation. (*a*) Except as provided in paragraph (*b*) of this section, this Maximum Price Regulation No. 142 shall not apply, and the General Maximum Price Regulation shall apply, to any sale at retail of a seasonal commodity

"(1) by any seller more than 5 per cent of whose annual sales of such seasonal commodity customarily occur during March; and

"(2) by any seller whose maximum price for such sale can be established under section 2 of the General Maximum Price Regulation.

"(*b*) The General Maximum Price Regulation shall not apply, and this Maximum Price Regulation No. 142 shall apply, to any sale of a seasonal commodity at retail if the maximum price established by the General Maximum Price Regulation is based upon an out-of-season sale of the same or a similar seasonal commodity purchased to be sold during the 1941 selling season but held over and sold during March 1942 at a price no higher than the highest price at which the seller sold such commodity during his last selling season and substantially lower than the maximum price which would be permitted to the seller under this Maximum Price Regulation No. 142."

Toward the end of May, a regulation covering prices of fall seasonal merchandise was issued. The substance of this regulation was reported in *Women's Wear Daily* for May 26, 1942, as follows:[1]

"Washington, May 25.—All 1942 fall styles of women's, girls' and children's cloth outerwear garments—coats, suits, dresses, and many

[1] For information on subsequent developments, see footnote, page 14.

other items—cannot be sold for prices above those charged in the 1941 fall season, under a new regulation issued today by Price Administrator Leon Henderson. Retailers, wholesalers and manufacturers of such garments are required to establish their price lines for the 1942 fall season at no higher than their 1941 fall season price lines. Fur garments and shoes, neither of which is treated in the present ruling, are understood to be under consideration.

"Inquiry at the Office of Price Administration as to whether it could be assumed that a similar order providing the same procedure would be established to apply to men's and boys' fall outer garments brought no response other than that it was not definitely known when the men's clothing order may be issued.

"The regulation—No. 153, Women's, Girls' and Children's Outerwear Garments—the first applying solely to finished wearing apparel, sets as the maximum price for each seller the highest price charged by him for a garment of substantially equal workmanship and quality during a base period of July 1 through Sept. 30, 1941.

"It becomes effective Friday, May 29, 1942.

"While specifying that prices for the types of apparel covered by the new regulation shall be no higher than those charged during last year's selling season, Mr. Henderson pointed out that the order takes into account simplification of styles and reductions in the yard goods going into a garment, as provided by War Production Board orders.

"The savings in yardage, estimated to be about 5 to 15 per cent per garment, will help manufacturers to absorb increased costs of materials and labor and still supply the consumer with a fully comparable garment at last year's price, it was stated."

XII

MARKETING TRENDS

1. DEVER COMPANY

PROPOSAL FOR CONVERSION TO A VOLUNTARY CHAIN

In April, 1936, the officers of the Dever Company, a corporate chain grocery organization operating in several states, decided to outline a policy to guide the company in the establishment of a voluntary chain (Dever wholesale units and independently owned retail stores) in the state of Iowa and in other states where discriminatory chain store taxes would, if held constitutional, make the operation of company stores unprofitable. Other companies in other states had already shifted, or were considering shifting, from a corporate chain basis to a voluntary chain basis, either as a means of avoiding discriminatory taxes or as a partial solution to labor problems. Several chains also were experimenting with wholesale selling to independent merchants.

For many years the officers of the Dever Company had given most of their attention to developing an efficient system for the distribution of groceries, vegetables, dairy products, and meats. From the time of the Federal Trade Commission investigation of chain stores in response to Senate Resolution No. 224 of the Seventieth Congress, however, the public aspects of the enterprise had become more important to the management.

A governmental question which threatened the very existence of many of the retail units of the Dever Company involved the discriminatory chain store tax laws which had been passed in a number of states. The first taxes against chain stores were enacted in Maryland, Georgia, and North Carolina in 1927, but state courts declared these invalid. The Supreme Court of the United States, however, sustained the Indiana law of 1929, which provided for a graduated store license tax. In 1935 the Supreme Court invalidated the Kentucky statute of 1930, which provided for a graduated gross receipts tax. A similar decision was rendered with respect to the gross receipts tax of the Wisconsin law of 1933. On the other hand,

in April, 1936, the Supreme Court consented to review on appeal of the State of Iowa a decision of a United States District Court in Iowa which had held the Iowa gross receipts tax unconstitutional. At that time 22 states had one form or another of discriminatory tax on chain stores. Graduated licensing taxes, for instance, had been passed in several states, including Alabama, where the rate varied from $1 to $112.50 a store; California, $1 to $500 a store; Colorado, $2 to $300 a store; and Florida, $10 to $400 a store. Graduated sales or gross receipts taxes had also been imposed in some states. Florida, for instance, had a rate of 5% on sales of chain stores; the rate in Iowa varied from a flat $25 on the first $50,000 of sales or receipts to $1,000 for each $10,000 of sales in excess of a total of $9,000,000.[1]

The extent to which these discriminatory taxes threatened the units of grocery chains was indicated by the president of The Great Atlantic & Pacific Tea Company, who, in a full-page advertisement in the annual *Voice of Business* published by the *New York Sun* on January 4, 1936, said:

> In the event that we receive no relief from discriminatory legislation in the courts, there are two courses open to us.
>
> We have, of course, made an exhaustive study of the so-called voluntary and cooperative chains. We have discussed the possibility of turning over our stores to our managers in states where taxation is excessive, on a lease or agency basis. However, there are objections to this plan, and I am convinced that the voluntary groups will be the next class of retail stores to be burdened with special taxes. There have already been several attempts by legislatures to include the voluntary with the corporate chains.
>
> Probably the simplest and most workable plan would be to sell our stores to our present managers in states where discriminatory taxes are passed, and enter the wholesale food business. Our warehouses, equipment, supervisory, and buying staffs would enable us, I believe, to service manager-owned stores and other good independent retailers much more efficiently and cheaply than most wholesalers. I understand that one large chain is already experimenting with a similar plan in a section where taxes have made the operation of stores prohibitive.

The foregoing statement aroused considerable interest and some concern among competent leaders in the independent wholesale

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[1] In 1936 the Florida Supreme Court upheld the tax on the number of stores in the chains but not the 5% tax on gross receipts. The United States District Court at Des Moines had declared the Iowa graduated receipts tax unconstitutional because it was arbitrary, but the case was appealed by the State to the Supreme Court of the United States.

grocery field. T. B. Terry of Laurel, Mississippi, president of the National-American Wholesale Grocers' Association, was quoted in the *Journal of Commerce and Commercial* for January 21, 1936, as follows:

Unless all signs fail, probably the overwhelming problem before wholesale grocers everywhere will be, in the all-too-near future, how to meet and survive new and most powerful and resourceful wholesale competitors, now retail chains. Foreseeing the future, one of the large chains of the West has already entered the wholesale field competing with you for the business of the individual retailers. One of the middle western concerns is now well into the wholesale business.

As president of National-American, I want to remind you that at no time have we, as an association, contributed to bringing about this situation. We have been misunderstood or criticized for not urging the use of tax legislation on chain competitors. We realized that competition like the fabled hydra is many-headed and will grow new heads as necessity arises. The retail head may be cut off but an even more terrifying head appears labeled "Wholesale."

Manufacturers as well as wholesalers in some territories, to start with, must soon overhaul their methods, their costs and their policies because the struggle that is to come will require all their ability, all their ingenuity and all their energy.

Remember that these new wholesalers are low cost manufacturers, low cost distributors, and vigorous merchandisers of their own brands. They will offer a full line of foods on a streamline basis.

Possibly some will continue to urge additional tax legislation. I fear that it will not only be almost impossible to enact legislation to protect the wholesaling middleman but that such legislation would probably punish many wholesalers as seriously as it would the newcomers. If the co-operating wholesale and retail grocers are legislated against then a consumers' co-operative will be resorted to. Do you suppose that politicians can be found who would vote for, much less sponsor, legislation to strangle the consumers' co-operatives?

Carl W. Dipman, editor of *The Progressive Grocer*, who spoke on *This Changing Food Business*[1] before the wholesalers' convention, discussed the issue of the way in which the chains would meet the discriminatory tax situation as follows:

If discriminatory taxes go too far, how will the chains meet the situation?

They will probably sell their stores to their managers or other parties, set themselves up as wholesalers, and operate their retail stores as voluntary units. Long before John Hartford of A & P made his recent statement, chain officials' thoughts and activities were heading in

[1] Published in pamphlet form.

that direction. As long as three years ago a prominent chain official told me that was what he had in mind. One or two chains have already switched to the wholesale-voluntary basis, a few others have made a start by laying the groundwork, and others are exploring the possibilities. And when they once switch to wholesaling, they may not go half way. They may open up more warehouses. In all probability they will operate these wholesale warehouses on a low-margin basis, possibly cash-and-carry.

If chain taxes and antagonistic legislation are carried to the point of driving the chains out of retailing, that may not prove to be the unmixed blessing that many people would like us to believe. It may easily intensify the wholesalers' competition instead of reducing it.

Let us suppose for the sake of argument, and this is only a speculation, that the A & P, operating on a wholesale-voluntary basis, should not be satisfied with the volume it gets in a certain state or area from its voluntary or agency stores. What is to prevent the A & P from letting down the bars and selling its coffee and other controlled lines to all independent grocers? How will you as a wholesaler enjoy competing with A & P coffee in the very stores on which you now depend for your coffee volume, perhaps even the stores now tied up with you on a voluntary arrangement? It may not stop there, for next may come canned milk, canned salmon, and canned foods of all kinds as well as other groceries. Even the cooperative and cash-and-carry wholesalers may not find this competition easy to meet.

Such a switch may also give the manufacturer some headaches. At present he needs to compete with A & P brands in A & P stores only. Eventually, and let me repeat this is pure speculation, he may have to compete with A & P brands in many independent stores.

And from the retailer's standpoint, A & P competition may not be removed either. He may still have the A & P voluntary or agency store in his midst even though under private management. Some managers, once cut loose from headquarters' red tape, may be able to shift their position more quickly and offer stiffer competition than they do now. On the other hand it is also true that some managers, when they are once cut loose from their blueprint directions and exercise their individual prerogatives, will probably make a terrible mess of operating retail stores of their own.

But all in all, independent retailers will have less to lose by such a change in chain-store policy than other factors in the food industry. They may even have some things to gain. Certainly more sources of supply and more brands will be open to them. And this demonstrates again that this independent grocer who was so maligned and bedeviled ten years ago seems at present in about as good a position to adjust himself to these new situations as anyone in the food business. In some areas we already have the chains courting the independents' friendship. In fact, it seems that everybody wants to be on a friendly basis with the independent grocer today as he is rising in power and influence.

I do not claim to be able to see into the future and foretell all that may or may not happen should antagonistic chain-store legislation be carried to the point of driving chains out of the retail food business. But without stretching our imagination very far, we can see that it is not entirely a one-sided proposition, and the results may not all be unmixed blessings.

We may even ask whether the *anti* approach is the correct one. We can all admit that many inequities exist that need correction. We may not have any love for the chain stores, and we may even say they brought their troubles on themselves. But purely from the independent wholesalers' and retailers' viewpoint, may we not well ask whether an approach based on hatred, malice, and envy is the proper approach? We may well ask whether an approach that attempts to correct the fundamental causes of the inequities that now exist—whether manifest among chains, manufacturers, super-markets voluntaries, or independents—is not the better one in the long run.

The management of the Dever Company was convinced that, if the high discriminatory taxes of Iowa were sustained, the company would have to discontinue its retail units in that state. The Iowa statute on graduated sales and licensing taxes "imposed upon every person within the state of Iowa engaged in conducting a business by a system of chain stores from any of which stores are sold or otherwise disposed of at retail tangible personal property such as goods, wares, and merchandise, an annual occupation tax," as follows:

(*a*) A specific amount on each person engaged in conducting a business by a system of chain stores to be determined as follows: (1) $5 for each store in excess of 1 and not in excess of 10, if said business is conducted at not in excess of 10 stores within this state under a single or common ownership, supervision or management. [There followed five additional classifications, which are given in Exhibit 1.]

EXHIBIT 1
OCCUPATION TAX ON CHAIN STORES IN IOWA

Number of Stores	Tax Rate per Store	Amount of Tax	Cumulative Total of Tax
2–10	$ 5	$ 45	$ 45
11–20	15	150	195
21–30	35	350	545
31–40	65	650	1,195
41–50	105	1,050	2,245
51 or more	155		

(*b*) An amount based on the combined gross receipts of each person on all of said business of each and all stores within this state under a

single or common ownership, control, supervision, or management, conducting a business by a system of chain stores, but which shall be computed by applying the following rates to the entire or combined gross receipts: (1) $25 when gross receipts are not in excess of $50,000, (2) $10 for each additional $10,000 or fraction thereof of gross receipts in excess of $50,000, but not in excess of $100,000. . . . [There followed

EXHIBIT 2
GROSS RECEIPTS TAX ON CHAIN STORES IN IOWA

Gross Receipts	Tax Rate	Amount of Tax	Cumulative Total of Tax
1st $50,000	$ 25 flat	$ 25	$ 25
$ 50,000 to $ 100,000	10 {for each additional $10,000 or fraction thereof}	50	75
100,000 to 150,000	25 " " "	125	200
150,000 to 200,000	60 " " "	300	500
200,000 to 300,000	75 " " "	750	1,250
300,000 to 400,000	100 " " "	1,000	2,250
400,000 to 500,000	125 " " "	1,250	3,500
500,000 to 600,000	150 " " "	1,500	5,000
600,000 to 700,000	175 " " "	1,750	6,750
700,000 to 800,000	200 " " "	2,000	8,750
800,000 to 900,000	225 " " "	2,250	11,000
900,000 to 1,000,000	250 " " "	2,500	13,500
1,000,000 to 1,250,000	275 " " "	6,875	20,375
1,250,000 to 1,500,000	300 " " "	7,500	27,875
1,500,000 to 1,750,000	325 " " "	8,125	36,000
1,750,000 to 2,000,000	350 " " "	8,750	44,750
2,000,000 to 2,500,000	375 " " "	18,750	63,500
2,500,000 to 3,000,000	400 " " "	20,000	83,500
3,000,000 to 3,500,000	425 " " "	21,250	104,750
3,500,000 to 4,000,000	450 " " "	22,500	127,250
4,000,000 to 4,500,000	475 " " "	23,750	151,000
4,500,000 to 5,000,000	500 " " "	25,000	176,000
5,000,000 to 6,000,000	600 " " "	60,000	236,000
6,000,000 to 7,000,000	700 " " "	70,000	306,000
7,000,000 to 8,000,000	800 " " "	80,000	386,000
8,000,000 to 9,000,000	900 " " "	90,000	476,000
9,000,000 and up	1,000 " " "		

25 additional classifications, which are given in Exhibit 2.] The tax imposed by subsection (*b*) hereof shall be computed for the annual period commencing July 1, 1935, and terminating June 30, 1936, and for each succeeding twelve-month period thereafter. The tax imposed by subsection (*a*) hereof shall be due and payable on July 1, 1935, and on July first of each succeeding year thereafter; the tax imposed hereby as far as measured by subsection (*a*) hereof, shall be computed on the basis of the number of stores operated by any person under a system of chain stores in this state as of July 1 of each taxable year. The tax

imposed by subsection (*b*) hereof shall be due and payable on August 1, 1936, and on August 1 of each succeeding year thereafter, or within 30 days after, any person liable for such tax shall cease entirely to do business within this state of the kind on which the tax is imposed.[1]

These taxes in Iowa were costs that would not apply to independent competitors. Because the average net profit in an Iowa Dever store was only $1,300 a year, it was obvious to the management that the company could not operate its 80 stores, making retail sales of approximately $4,400,000 a year, with a tax cost of $86 a store for the occupation tax and $1,828 a store for the gross receipts tax, or a total of $1,914 a store.[2] The company paid the occupation tax but withheld the gross receipts tax pending determination of its constitutionality. The $1,300 net profit for each store included all sources of profit to the company.

If the plan of becoming a voluntary chain in the states with high discriminatory taxes were adopted by the Dever Company, the warehouse units of the company would act as a wholesaler, and some arrangement would be made to sell existing store units to the managers. The name "Dever" probably would be retained by the voluntary chain, and the name of the proprietor would also be shown on the sign of the store. Since the company would lose the retail profit under this arrangement, the management believed that the number of stores would have to be doubled in the area affected, in order that the aggregate profit formerly obtained in the territory might be secured. Thus, under this plan, private wholesalers might expect competition from Dever wholesale units for the trade of aggressive independent grocers.

Another possibility for meeting the tax problem was the conversion of existing retail units into consumer cooperative societies. Such institutions had existed in England and in other parts of Europe for a great many years, but they had not gained a substantial foothold in the United States, probably because the chain store movement in this country had provided low costs of distribution. One of the problems, therefore, in connection with consumer cooperatives in the United States was whether these societies could further reduce the costs of distribution sufficiently to provide an incentive for their organization. The management of the Dever Company

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[1] Iowa Session Laws, 1935, p. 89.

[2] The largest grocery chain in Iowa, with an average net profit of $1,100 for each store, had estimated that its chain tax cost would be $3,300 a store.

did not intend to consider this solution in 1936, but some officers thought that the development of such societies should be watched currently, for there was a possibility that they might become important factors in retail distribution in the future. In the first place, several departments of the Federal government were encouraging the establishment of consumer cooperative societies. Further, in much current legislation cooperatives were made exempt from taxation.

The officers of the Dever Company preferred to operate as a corporate chain, but they believed that the voluntary chain setup was one way in which the company might preserve its goodwill and net profits in states where taxes were unduly discriminatory. Although the 80 stores in Iowa represented but a small fraction of the total number which the company operated, the executives preferred, if necessary, to experiment with revised methods of distribution rather than to close the stores. The company had one warehouse which could be used as service wholesale headquarters for the stores in Iowa. In order to make such a venture yield the same aggregate profit which the company formerly obtained from the retail stores, the management would seek additional retail outlets among progressive independent merchants.

From the standpoint of the store managers, the proposed sale of stores to them had several advantages. The manager, by acquiring ownership of the fixtures, stock, and leaseholds, would become the owner of the retail unit and would be entitled to whatever he could earn. He would also have the right to use[1] the Dever name with its attached goodwill, subject to the observance of minimum standards of store operation. The investment which a manager would have to make in inventories and fixtures was not large; and if he were to maintain the existing sales volume, he could pay interest on funds borrowed and make payments on the principal of the debt.[2] A former manager, operating his own store under the voluntary plan and maintaining the former level of efficiency of retail operation, should be able to earn an amount equal to his former salary and a net profit in addition. The executives of the Dever Company did not

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[1] The legal restrictions on use and the manner of conveying the right to use the name had not been determined.

[2] The company had made no plans for financing the purchase of stores by managers. The executives realized that many of the managers had substantial balances in savings accounts. The officers also believed that banks would find the managers

know how much of the average profit of $1,300 in each store represented retail profit and how much was gain from wholesale and manufacturing operations. One officer estimated, however, that the store manager would expect a minimum prospect of profit of $500 over and above his former salary as manager. The extra initiative which a manager might show if he operated his own business was expected to increase further the prospect of net profit. On the other hand, under the proposed plan the store owner was not guaranteed an income.

The investment of managers in fixtures and stock in stores would probably range from $2,500 to $10,000, depending on the size and type of unit. The company had combination stores, handling groceries and meats, and others carrying only grocery items. In the case of the all-grocery units, managers might expect to pay $500 for equipment and $2,000 for inventory.[1] Managers of combination stores would have to invest from $3,500 to $5,000 in equipment and $5,000 in inventory. The combination stores had more modern show cases, at least two complete stocks of merchandise (to permit prompt service of customers), and expensive refrigerating equipment. These stores were larger in size than the grocery units and also had more items in stock.

The officers of the company believed, furthermore, that a Dever wholesale unit should be able to provide independent retail merchants with more service at a lower cost than could independent wholesalers or existing voluntary chains sponsored by wholesalers. In the first place, most wholesalers provided retailers with dry groceries and a few specialties only, whereas the Dever warehouse delivered 100% of the requirements of its stores, excluding store delivery merchandise.[2] In Dever stores, sales were divided as follows: fresh fruits and vegetables, 13%; meats and fish, 18%;

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to be good risks. If forced to do so, the company could finance the sale, but this plan did not appeal to the officers because of the psychological effects that the debt might have on managers and their probable view of their freedom in relations with the Dever wholesale unit.

The officers also realized that any contract of sale must be a bona fide one, which would leave the control of the retail business in the hands of the purchaser. This view was supported by the decisions of the U.S. District Court for the Southern District of West Virginia in *Gulf Refining Co.* v. *Fox*, 11 Fed. Supp. 428, and of the United States Supreme Court in its review of said case, 56 S. Ct. 518.

[1] These were average figures; each store would be handled separately if the plan was adopted.

[2] "Store delivery merchandise" is that delivered direct to store units by manufacturers, usually because of the perishability of the merchandise. Examples are products of Standard Brands and of the National Biscuit Company.

butter and eggs, 9%; bread and other baked goods, 5%; and dry groceries, 55%. The many years of experience which the company had had in handling perishables were thought by the management to be of considerable competitive value against wholesalers who had only recently started to handle perishables. Another advantage of a Dever unit lay in its economy of operation, which in the wholesale division was partly the result of the fact that retail units bought nearly all their requirements from one source. Economical schedules of deliveries were therefore possible. Dry groceries were delivered normally once a week and in large quantities, and perishables were usually delivered daily.

Detailed plans of action had not been determined by the officers of the company by April, 1936. In order to be prepared for an emergency, however, they planned to continue discussions of the voluntary chain idea, since many questions of policy had to be settled if action were necessary. Some sort of contract arranging terms of sale, right to use the Dever name, and other matters would be required. The officers had agreed, however, that voluntary members should be free to buy from whomever they pleased. If a Dever wholesale unit was to earn retailers' patronage, it would have to do so on a basis of efficiency and low cost of service. Retailers were expected to be better satisfied by such an arrangement, and the plan would cause the buyers and managers of wholesale units to be on the alert for every opportunity to save expense. Nevertheless, the officers of the Dever Company realized that its managers had had little training in buying. Since managers had been accustomed to taking orders from supervisors and therefore had had little opportunity to develop sales resistance, the executives believed that managers might become prey for salesmen of other manufacturers and wholesalers. The chief protection against this danger was the well-established order routine of store managers.

One of the main problems before the management was to ascertain the margin for wholesaling that would be needed under the proposed plan. A typical operating statement for an important division of the company in a recent year was as shown in Exhibit 3. The opinion of some officers as to how the expenses would be affected by a voluntary chain setup follows.

Some of the nonstore expenses, such as store accounting and advertising, were really expenses of independent retail stores and in the reorganization would be deducted from the wholesaling margin.

What to do about advertising and credits and collections, however, constituted a problem. Under the proposed plan the officers thought that the supervision expense would be substantially reduced, though not eliminated. The company would not have its former authority over the stores and therefore would not need so many supervisors. Many of the duties of these men, such as checking advances and reductions in prices in the stores, making out credits for damaged goods, checking the appearance of stores, reading

EXHIBIT 3
DEVER COMPANY
Operating Statement for Division X, 1934

Net Sales			100.00%
Cost of Merchandise Sold (including some buying expense)			79.16
Gross Margin			20.84%
Retail Store Expenses:			
Store Managers' Salaries	5.10%		
All Other Salaries and Wages	3.83		
Tenancy Costs	2.35		
Depreciation of Furniture and Fixtures	0.34		
Light, Heat, Water, Power, and Refrigeration	0.75		
Supplies	0.55		
Insurance	0.13		
Unclassified	0.55		
Total Expenses Charged to Stores		13.60%	
Nonstore Expenses:			
Transportation from Warehouse to Store	0.98%		
Advertising	0.52		
Taxes	0.33		
Warehousing and Handling*	0.52		
Supervision	0.87		
Administration†	1.20		
Total Nonstore Expense		4.42	
Total Expense before Interest		18.02%	
Interest (including interest on investment)		0.48	
Total Expense			18.50
Net Profit			2.34%

* Including labor, rental expense, and depreciation of physical plant.
† Including store accounting 0.7 %, divisional office expense such as buyers, office managers, and traffic department, and allocated share of general administrative overhead.

cash registers, observing the salesforce, collecting and depositing receipts, and taking inventory, would not be required under the new setup. On the other hand, the company would have to maintain contact with the stores in some personal way. There also might be some reduction in advertising expense, and some economy was thought to be possible in administrative expenses. Expenses involved in meetings of managers and miscellaneous territorial expenses would be reduced 0.25%.

On the basis proposed would the Dever Company be able to compete effectively with a typical wholesale grocer operating a voluntary chain, such as the Atlas Wholesale Grocery Company (page 595)? How would their margins, expenses, and profits probably compare?

What other alternatives should the Dever Company have considered?

Appendix A

Some Typical Operating Figures for Various Types of Retail Food Stores in the United States

(Net Sales = 100%)

Item	42 Coopera-tives (1937)	1,051 Inde-pendent Stores (1936)	26 Super-markets (1934)	34 Regular Food Chains (1934)
Gross Margin	18.5%	18.5%	17.2%	24.04%
Salaries and Wages	9.6%	10.5%	7.9%	12.58%
Rent (incl. heat, light, and power)	2.55	2.2	3.0	4.22
Advertising	0.35	0.5	0.8	1.08
Other Expense	4.1	3.2	2.2	4.53
Total Expense before Interest	16.6%	16.4%	13.9%	22.41%
Net Profit*	2.3	2.1	3.3	2.28
Rate of Stock-turn (times a year)	12.8	15.3	17.2	8.38

* Figures not fully comparable in all cases.

Source: Malcolm P. McNair, Stanley F. Teele, and Frances G. Mulhearn, *Distribution Costs: An International Digest* (Boston, Harvard Graduate School of Business Administration, 1941).

Some Typical Operating Figures for Wholesale Grocers in the United States, 1936

Item	Firms Selling Distributors' Brand Merchandise (Percentage of Net Sales)			Voluntary Group Sponsors (Percentage of Sales to Group Members)		
	10%–20%	20%–30%	30%–50%	Less than 10%	10%–50%	50%–100%
Number of Firms	10	15	7	7	19	14
Gross Margin	10.8%	12.4%	12.9%	13.5%	11.4%	9.1%
Total Selling Expense	2.9%	3.3%	3.4%	4.2%	2.8%	2.0%
Total Administrative Expense	2.8	3.1	3.2	3.1	2.9	2.5
Total Warehouse and Shipping Expense	1.4	1.6	1.8	1.8	1.5	1.4
Total Delivery and Cartage Expense	1.1	1.4	2.0	1.5	1.4	1.4
Other Expense	1.2	1.5	1.8	2.1	1.5	1.5
Total Expense	9.4%	10.9%	12.2%	12.7%	10.1%	8.8%
Net Margin	1.4	1.5	0.7	0.8	1.3	0.3
Rate of Stock-turn (times a year)	5.9	5.2	5.5	5.1	5.4	6.5

Source: Malcolm P. McNair, Stanley F. Teele, and Frances G. Mulhearn, *Distribution Costs: An International Digest* (Boston, Harvard Graduate School of Business Administration, 1941).

Appendix B

Voluntary-Chain Contract of the Danbury Company,[1] Formerly a Corporate Chain

This Agreement, made this..........day of..............193....
by and between Danbury Company, a corporation organized under the laws of the State of........, with its principal office at.............
(hereinafter called the "party of the first part") and...............
whose address is...
(hereinafter called the "party of the second part")

Witnesseth:

Whereas, the party of the first part has been engaged in the retail sale and distribution of groceries since......; has spent millions of dollars in advertising the name of Danbury whereby it has acquired a

[1] Fictitious name.

valued reputation and a large following in retail trade; has evolved and developed a modern method of selling and delivery of merchandise, an improved system of accounting, and expert advertising; has adopted the latest and best methods of chain-store operation now to be known as the DANBURY COOPERATIVE MERCHANDISING SERVICE; owns at the present time a large warehouse completely equipped, operates a complete and modern bakery and coffee-roasting plant and is equipped to furnish these up-to-date services; and

WHEREAS, the party of the second part realizes that practically 100% of the food business was, in earlier years, done by the individual retail merchants throughout the United States; and that in recent years the development of modern merchandising principles has caused other forms of retail food distribution to encroach with disadvantage to the individual retailer upon the business of such retailer, and that to retain the business he now has, and to increase the same, he must place himself in a position to obtain more modern economies and facilities and to apply to his own business, principles and methods similar to those of his present competitors; that it is necessary that he and a large number of other independent grocers unite and cooperate on a mutual basis so that their combined purchasing power be centralized, and that their merchandising efforts be concentrated; and

WHEREAS, Danbury Cooperative Merchandising Service was organized, planned, evolved, and developed for the purpose, among others, of obtaining for the party of the second part and other retail grocers entering into agreements with the party of the first part, at the least possible cost on quantity purchases of merchandise, discounts and other allowances from manufacturers, and for the purpose of arranging direct deliveries of merchandise including Fresh Fruits, Vegetables, Meats, Provisions, Supplies, and other merchandise to individual retailers; and

WHEREAS, the party of the second part is desirous of obtaining the advantage of the aforesaid service economies and assistance, and to do so is desirous of complying with the terms and provisions of this agreement:

NOW THEREFORE, in consideration of the premises, and of the mutual covenants hereinafter contained, and of the sum of One Dollar ($1.00) paid to the party of the first part by the party of the second part, concurrently with the execution and delivery of this agreement, receipt of which is hereby acknowledged, it is covenanted and agreed by and between the parties hereto as follows:

The party of the first part agrees to:

1. Operate and maintain a warehouse of sufficient size to insure a complete assortment of groceries and such other products as are needed in a retail grocery store.

2. Purchase merchandise in such quantities as to insure lowest possible prices to the party of the second part.

3. Operate and maintain coffee-roasting plant, printing plant, laundry, bakery, and egg candling department for the full requirements of the party of the second part.

4. Place advertising in local and surrounding newspapers; furnish each store sufficient copies of weekly circular; maintain advertising department, artists, and copywriters for the benefit of the party of the second part.

5. Maintain fruit and vegetable buyers on the local market and arrange for delivery of such produce to store of the party of the second part at lowest prices possible.

6. Arrange for and make available legal advice and service when required by the party of the second part.

7. Cause to be furnished insurance, group, fire, and liability, at lowest possible cost to the party of the second part.

8. Maintain complete accounting department to cover all warehouse and store operations and furnish the party of the second part a monthly statement of his operating expenses, sales, profits, and other data.

9. Maintain sales department for benefit of the party of the second part, furnish suggested retail prices and gross margins of profit on each invoice.

10. Pay at the option of the party of the second part all expense items in the store operation of the party of the second part, keep suitable records of same, accept deposits of daily sales, and reimburse the party of the second part not later than the 15th of the following month for net profits of said store.

11. Furnish complete course in chain grocery merchandising with four books on groceries, four books on fruits and vegetables, the monthly issue of *Chain Store Manager* and *Chain Store Age*, and furnish other valuable information.

12. Furnish uniform store sign for outside of store, such sign to remain the property of the party of the first part.

13. Furnish paint for store front so that all stores may be uniform and of the same color.

14. Furnish, pack, can, or prepare or cause to be packed, canned, or prepared, a reasonable assortment of merchandise under the Danbury label which should net larger margin of profit to the party of the second part than do regular advertised lines, thereby making more profit for member stores.

15. Maintain a staff of food merchandising experts who will call at least twice each month on the party of the second part to cooperate with and to assist the party of the second part in his merchandising problems.

16. Call regular meetings of all member stores, that each and every one may benefit from the experience of other members, consult and endeavor to lessen the troubles and burdens of all.

17. Obtain the maximum amount from manufacturers in the way of advertising and quantity allowances and pass such amounts on to the party of the second part.

18. Have books of Danbury Company audited regularly and reports of the same furnished to the party of the second part.

19. Render invoices for merchandise at net cost of said merchandise.

The party of the second part agrees to:

1. Make all purchases from the party of the first part except when the party of the first part cannot or is unable to obtain such merchandise.

2. Sell such merchandise as is advertised in newspapers, circulars, or elsewhere, under the Danbury name—commonly known as specials—and maintain as near as possible the recommended gross profit.

3. Furnish party of the first part monthly inventory of merchandise and such other daily or weekly reports as are necessary for the conduct of this business.

4. Make a deposit of $40.00 for store sign which deposit shall be returned at cancellation of this contract less depreciation of 30% per year.

5. Furnish services and pay cost of painting store front that they may all be uniform.

6. Cooperate to the extent that he will follow out the recommendations of the majority of the members as far as it is possible to do so.

7. Furnish the party of the first part with daily sales reports.

8. Make daily deposit of sales to credit of Danbury Company less necessary amounts paid out or pay each week's purchases not later than Wednesday of the following week, which will effect saving in credit losses and make for lower prices of merchandise to the party of the second part.

9. In the event the party of the second part does not wish to avail himself of the banking service, he will make a deposit of $........ as a bond to insure prompt payment of invoices for merchandise. Such amount to be returned to party of second part in event of cancellation of this contract.

10. Pay to the party of the first part for services rendered in warehousing, buying, advertising, and such other services as have been enumerated in this agreement a certain percentage of total sales of the party of the second part as the books of the company show to be the exact cost of rendering such service, and in no event will this exceed 5% of gross sales of store of party of second part.

11. Pay to the party of the first part an additional 2% of total sales as the only profit that the party of the first part is to receive, same to be charged to party of second part weekly.

It Is Mutually Agreed between the Parties Hereto That:

1. This agreement shall continue in force for five years from the date hereof, and thereafter for successive periods of one year each, subject however to the right of either party to cancel the same upon one party giving the other party written notice at least 30 days prior to such cancellation.

2. This agreement shall not be assigned by the party of the second part without written consent of the party of the first part.

3. This agreement shall be and become binding upon the parties hereto only when accepted and signed on behalf of the Danbury Company by one of its duly authorized officers at its home office.

4. No agreements of any kind not contained herein shall be binding upon either party unless in writing and accepted by one of the duly authorized officers of Danbury Company.

In Witness Whereof, the party of the first part has caused these presents to be signed and its seal to be hereunto affixed by its duly authorized officers and the party of the second part has hereunto set his hand and seal the day and year first above written.

2. ATLAS WHOLESALE GROCERY COMPANY

MEETING CHANGING TRENDS

The Atlas Wholesale Grocery Company had its main office and warehouse and four branches in Iowa. Its sales, which in 1934 were approximately $4,000,000, were secured from a wholesale trading area including a population of over 500,000. Ten per cent of the sales originated in a cash-and-carry department; the remainder were made on a delivery-and-credit basis. The company was affiliated with the National Grocers' Cooperative,[1] a large voluntary chain.

The president of the Atlas Wholesale Grocery Company had general supervision of the company's operations. He was relieved of detail work by his two vice presidents (see Exhibit 1). In general, vice president no. 1 had charge of all merchandising activity, and vice president no. 2 was responsible for all financial matters. The two vice presidents, in practice, conferred with each other on all important problems. The branches were in charge of managers, who reported to the vice presidents.

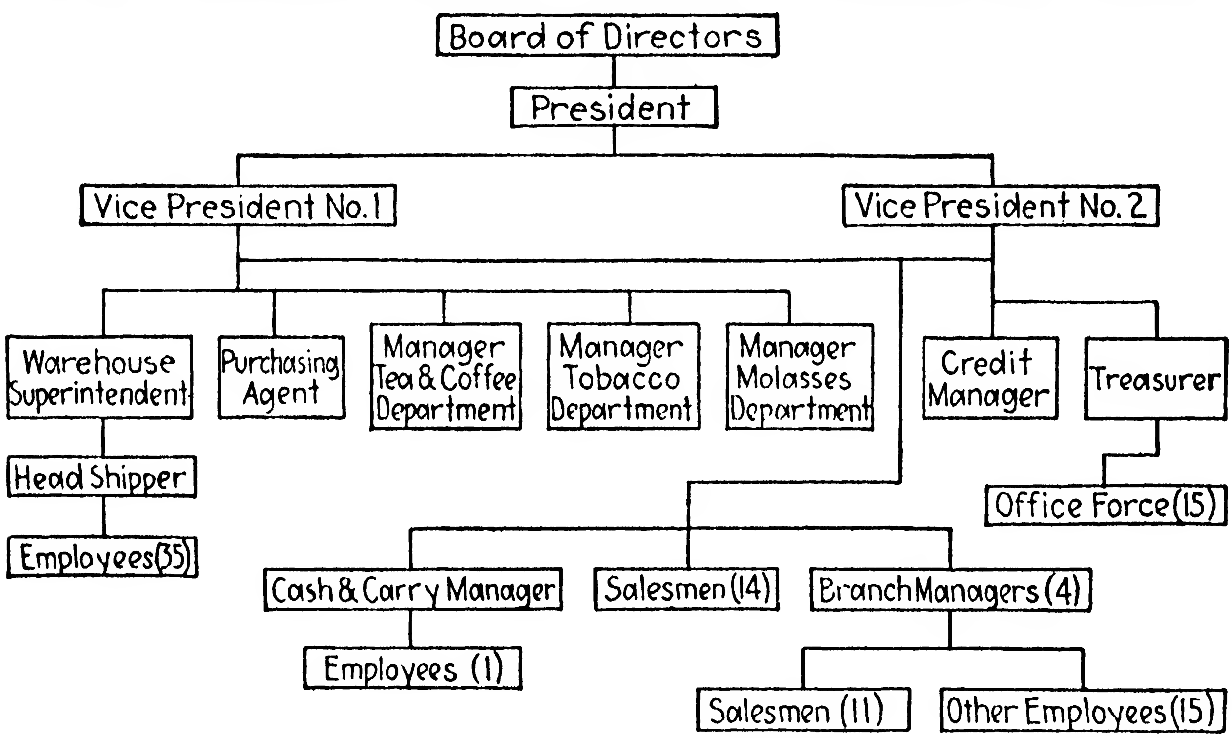
The Atlas company sold more than 1,200 items of merchandise, principally classified as follows: canned goods, dried fruits, tea and coffee, molasses, cereals, soaps, sugar, household supplies, tobacco products, confectionery, beverages, nuts, condiments, and paper products. The vice presidents supervised the buying of all these products. Vice president no. 1 bought all the canned goods, and vice president no. 2 bought sugar, cereals, and flour; the purchase of tobacco products, tea and coffee, and molasses was delegated to the managers of the respective departments. The purchasing agent and the branch managers bought the remainder of the merchandise. Branch managers, who purchased about 15%

[1] Fictitious name.

of the products sold by the branches, bought only certain standard items designated by the vice presidents.

Tobacco products, tea and coffee, and molasses were handled in separate departments under the supervision of department managers. Tobacco products were placed in a special department because of the highly specialized nature of many smokers' articles. Tea and coffee were segregated because the company imported and packed its own teas and roasted its own coffees. The company also imported its own molasses. By engaging in such activities the

EXHIBIT 1.
ATLAS WHOLESALE GROCERY COMPANY. ORGANIZATION CHART.



company was able to obtain a higher margin of profit than it otherwise could and to exert more satisfactory control over the quality of these products.

The company carried an average inventory of $500,000 at cost. The vice presidents did not restrict buyers by any formal purchase limits; they supervised them only in a general way and allowed them considerable discretion. By means of frequent physical inventories, which were taken at varying times for different products, the buyers determined the quantity of products on hand. They kept stock sheets, showing both inventories and purchases of individual products, which the vice presidents scanned from time to time in order to have a check on buying activity. All orders placed direct by the branch managers were routed through the

home office and examined by the vice presidents. In addition, each branch manager furnished a biweekly report of surplus stock, a copy of which was given to each of the buyers in the home office for inspection. The surplus-stock report showed quantities of items detected as slow moving by the branch manager, as well as the stocks of other items requested by the home office. For each product the quantity purchased depended primarily on the management's interpretation of current price trends. Although this purchasing procedure was quite informal and decentralized, its efficiency was attested to by an average stock-turn of 8 times a year and a gross margin of 12%, secured in the face of strenuous price competition.

The vice presidents were responsible for the addition and elimination of products. New product suggestions were obtained from the buyers, from manufacturers' salesmen, and from the buying division of the National Grocers' Cooperative.

The pricing function was exercised by all the buyers except the branch managers. In general, the company tried to set prices which would yield both the wholesaler and the retailer an adequate profit and at the same time permit a competitive retail price. Each week the company offered special prices on standard items in order to meet price competition of chain stores. In quoting prices to customers, the company used delivered prices. Variations in freight rates were wide enough to require the division of the market into three zones, with different delivered prices for each zone. The company also established price differentials for full-package and broken-package lots. For most products the company established a less-than-package unit and required customers to buy either in unit lots or in full-package quantities. A case of salmon, for instance, contained four dozen cans; the unit lot was two dozen cans.

The company's products were sold unbranded, under manufacturers' brands, under the Atlas brand, or under the brand of the National Grocers' Cooperative. The Atlas brand and the National Grocers' Cooperative brand were of about equal importance, and together they represented 75% of the sales of branded goods. As a general policy, manufacturers' brands were carried wherever there was a strong demand for those brands and when the company was able to make a profit on them. Exclusive agencies were held on a few of these manufacturers' brands, but the number was small because the company did not devote much time to their development. The Atlas brand, which the company had originated in

order to obtain a higher markup than that available on many packers' brands, was applied to a complete line of canned goods, packaged dried fruits, tea and coffee, and condiments. According to an executive, the higher markup was the result of lower buying prices rather than of higher selling prices. The company did not carry packers' brands of products which had large sales under the Atlas brand.

The Atlas company had joined the National Grocers' Cooperative in 1928. This organization was a voluntary chain association of wholesalers and retailers operating over a large section of the country. The company held the wholesale franchise of the National Grocers' Cooperative for its normal wholesale area. Under the terms of the franchise the company agreed to pay a monthly buying fee to the association, to collect association dues from member retailers, and to cooperate by serving retailers of the National Grocers' Cooperative. The central association acted as broker for the affiliated wholesalers by seeking out manufacturers and other sources of supply, arranging for prices, and notifying the wholesalers concerning these arrangements. Under this plan, the central association placed orders sent in by any wholesaler. The association also provided promotional material for member retailers and operating suggestions for both wholesalers and retailers. In 1933 only 260 of the 2,000 customers of the Atlas Wholesale Grocery Company were members of the voluntary chain, but these retailers contributed 51% of the company's total business. This concentration of purchases was the chief result of the company's membership in the National Grocers' Cooperative; whereas many retailers bought from several wholesalers, member retailers tended to buy most of their needs from the wholesaler of the National Grocers' Cooperative serving their territory.

In order to meet the competition of local wholesalers, the Atlas company operated four branches in various parts of its market. These branches made possible savings in shipping expense and facilitated prompt deliveries to customers. Each of the branches was in charge of a manager, who supervised the salesmen, administered the details of credit, maintained and controlled complete stocks, and bought certain products. The branch managers were required to provide the home office with copies of all orders secured by their salesmen, purchase orders which they placed direct, stock

reports, and any special reports desired by the management. Vice president no. 2 periodically visited the branches and made a personal inspection of stocks and personnel. The branches made 45% of the company's total sales, the largest branch accounting for 17.5% of total sales.

The Atlas company relied almost entirely on personal selling to secure orders. It had done some advertising, but this had been infrequent and devoted entirely to the Atlas brand. The company employed 25 salesmen, 14 of whom operated from the home office and 11 from the branches. All the salesmen sold all types of products to all types of customers in their territories. The salesmen were paid either a straight salary or a commission on gross profit, as they preferred. The trend was more and more toward a straight salary, which averaged about $50 a week. Salesmen provided their own cars, and the company paid their actual traveling expenses plus an allowance for depreciation on the cars. In addition to selling, the salesmen were required to collect slow accounts, to investigate the credit standing of new accounts, and to aid retailers wherever possible in the operation of their stores. Each day salesmen were required to send in their sales slips, collection blanks, and collections. Salesmen were not allowed to vary prices. The two vice presidents retained general supervision of the salesforce but delegated management of branch salesmen to the branch managers.

The salesmen called weekly on all types of customers, including retail grocers, institutions, hotels, summer camps, tobacco stores, and industrial concerns. In 1934 the company had approximately 2,000 accounts on its books. The number of accounts had been as high as 3,000; but in 1929, after a study initiated by the National Grocers' Cooperative, the company decided not to solicit orders from customers who purchased less than $80 worth of merchandise a month. This policy resulted in the loss of approximately 1,000 accounts between 1929 and 1934. During this period, since the number of salesmen was not reduced, the salesmen were able to spend more time with the customers retained. Although the results of this policy were distorted by the change in business conditions after 1929, the management believed that the policy had lowered the expense percentage.

The company's competitors included 30 wholesale grocery firms, all of which were smaller than Atlas, manufacturers who sold directly

to retailers, specialty wholesalers, and chain grocery stores. The basis of competition was both service and price.

The company extended credit to all its customers except those who bought in the cash-and-carry department. Orders from new customers were not delivered until the credit of these customers had been approved by the credit manager. In passing on the credit standing of a customer, the credit manager used both the reports sent in by the salesmen and the commercial rating books. In the administration of credits, the branch managers were permitted to exercise some discretion. Credit terms were 2%, 15 days from date of invoice; net, 30 days. Any customer who failed to pay his bill at the end of 30 days was not allowed to place further orders. The salesman who had sold the account then attempted to collect payment. If the salesman failed to collect, the credit manager made a personal call on the customer and tried to work out a schedule of payments. Trade acceptances also were used successfully in the collection of overdue accounts.

The cash-and-carry department had been started in the home office in 1927 in order that the competition of independent cash-and-carry wholesalers might be met and customers served whose credit rating was unsatisfactory. By 1934 this department was contributing approximately 10% of the company's total business. The cash-and-carry department sold about 500 items, most of which were staple goods. No private brands were carried. Sales were made only in full-package lots and at an average price differential of 5% under the company's regular prices. The department was managed by one man, who had one assistant. Customers of the cash-and-carry department were principally small retailers located within a short radius of the warehouse. The average unit of sale in the cash-and-carry department was $12, which was considerably below the average minimum of $20 required of regular customers. The costs of operating the cash-and-carry department were estimated to be 3% of sales, including, in addition to direct expenses, an allowance of 1% of sales for administration and a charge of ½ of 1% of sales for moving goods from the warehouse into the cash-and-carry department.

The net sales of the Atlas Wholesale Grocery Company in 1933 were $3,400,000. In that same year the expenses of operating the company, including the branches and the cash-and-carry department, were as follows:

General and Administrative	$115,249.16	36.7%
Selling	97,438.78	31.0
Warehouse	50,289.97	16.0
Delivery	18,849.60	6.0
Building	21,991.20	7.0
Interest (out of pocket)	6,283.20	2.0
Miscellaneous	4,058.09	1.3
Total	$314,160.00	100.0%

The major problem faced by the Atlas Wholesale Grocery Company, in the opinion of the executives, was that of enabling independent retailers to operate more efficiently in order that they might provide a better market for the company. It was this problem which had induced the company to associate itself with the National Grocers' Cooperative. This step, however, had provided only a partial solution of the problem because it applied to only 260 of the company's total of 2,000 retail accounts. The company attempted to have its salesmen work with retailers in order to improve their methods of operation, including display, other promotional plans, and accounting methods. The company had developed a standard accounting system for use by retailers; it also collected operating figures from retailers, and from these prepared standard operating ratios. The executives then compared the data of retailers who were not operating at a satisfactory profit with the standard ratios in order to determine causes of unprofitable operation. The company also tried to help retailers by suggesting retail prices. The executives believed that these steps had been of benefit to the retailers, but they were not satisfied that the problem had been solved.

Should the Atlas Wholesale Grocery Company have undertaken to expand either its voluntary chain or its cash-and-carry department? Should the management have considered any other possible courses of action?

3. CRESCENT COMPANY

EFFECT OF DECREASED AUTOMOBILE USE ON SUPERMARKETS

In the early months of 1942, the president of the Crescent Company, a chain food organization, in endeavoring to formulate policies for the current period, gave attention to the possible effects of the rubber and gasoline shortages on the operation of supermarkets. For the preceding seven years, the major emphasis in the successful expansion of the company had been placed on supermarkets; but the changes in the domestic life of consumers caused by war measures, particularly the rationing of automobiles, tires, and gasoline, seemed likely to restore in some degree the importance of the neighborhood store in the distribution of food. Therefore the president of the Crescent Company asked the market research division to assemble all its available data on consumer food-buying habits and to analyze the problem facing supermarkets in the light of these data.

The Crescent Company had been incorporated on August 15, 1925, in New Jersey, to take over the business of the company of the same name founded in 1915. Originally the company had consisted of approximately 200 small neighborhood stores situated in several Middle Atlantic states. During the following years, the new management had pursued a policy of expansion, acquiring small independent chains, until in 1935 it operated more than 400 units and had achieved an annual sales volume of $18,000,000. Most of these stores were small neighborhood stores; only a few were supermarkets. In 1935 the company began to stress supermarkets in its expansion program. Many of the small neighborhood stores were closed as supermarkets were opened; and by January 1, 1942, almost 30% of the company's 225 units were of the supermarket type, these stores accounting for approximately 75% of the company's total sales volume of $27,000,000. Of the company's 65 supermarkets, 33 were of a neighborhood character (some of these 33 locations being classified as minor or isolated, others as intermediate), that is, they drew approximately 70% of their trade from within a half-mile radius; 30 were located in major shopping localities and downtown business centers, drawing 50% of their trade from beyond the half-mile zone; and 2 were of the very large supermarket type, situated at the peripheries of the adjacent trading areas and attracting more than 80% of their trade from beyond the half-mile zone.

The report which the chief of the market research division prepared for the president of the company read as follows:

Analysis of Consumer Food-buying Habits

This report is based on the statistics on consumer food-buying habits which this division has gathered over a period of 10 years, partly from the Crescent Company's operations and partly from the operations of other chain food distributors. Our study clearly indicates the following findings:

(1) The distance that a person will walk to purchase foodstuffs is definitely limited. From interviews with more than 200,000 "walk" customers of various types of food stores in numerous localities, the fact was established that more than 80% of those interviewed lived within one-half mile of the store patronized.

(2) The proportion of customers who ride to a store varies according to the type of location, size of city, and purchasing power of the tributary population. For all types of stores combined, this percentage was only slightly higher on Saturdays than on weekdays.

(3) The percentage of customers who drive to supermarkets and "drive-ins" is high, frequently 25% higher than the percentage of walk customers on Saturdays. The explanation lies not so much in the type of location as in the type of operation. Ride customers account for a larger proportion of sales in supermarkets than walk customers, both on weekdays and on Saturdays.

Sales to Customers According to Methods of Travel

	Weekdays			Saturdays		
	Walk	Automobile	Public Conveyance	Walk	Automobile	Public Conveyance
% of Customers	57.5%	40.6%	1.9%	37.3%	61.7%	1.0%
% of Sales	38.2%	60.6%	1.2%	22.2%	77.0%	0.8%
Average Purchase	$0.74	$1.66	$0.83	$1.25	$2.71	$1.46

Basis: 7,584 customer interviews in 8 Crescent supermarkets.

(4) Ride customers visit stores less frequently than walk customers. (Public conveyances are used by a negligible proportion of our customers.)

Frequency of Visit

Type of Customer	Customers Interviewed on Weekdays		Customers Interviewed on Saturdays	
	Once or Twice per Week	Three or More Times per Week	Once or Twice per Week	Three or More Times per Week
Walk	34.3%	65.7%	43.2%	56.8%
Automobile	60.8	39.2	77.2	22.8
Public Conveyance	65.2	34.8	82.0	18.0

Basis: 7,584 customer interviews in 8 Crescent supermarkets.

(5) The average sale per customer increases with the distance traveled. More than 60% of weekday customers and 49% of Saturday customers live within one-half mile of the store.

CLASSIFICATION OF CUSTOMERS AND SALES ACCORDING TO DISTANCE

Zone	Weekdays			Saturdays		
	% of Customers	% of Sales	Average Purchase	% of Customers	% of Sales	Average Purchase
Less than ¼ Mile...	34.9%	24.5%	$0.78	24.8%	16.6%	$1.45
¼–½ Mile.........	26.6	24.4	1.03	24.2	21.0	1.88
½–¾ Mile.........	9.7	11.1	1.27	12.8	13.5	2.28
¾–1 Mile..........	6.6	8.3	1.41	7.7	8.3	2.35
Beyond 1 Mile.....	15.6	22.3	1.59	21.5	27.9	2.81
Out of Town.......	6.6	9.4	1.58	9.0	12.7	3.09

Basis: 7,584 customer interviews in 8 Crescent supermarkets.

(6) Couples account for only 15% of weekday sales and 30% of Saturday sales, but their average purchase is substantially greater than that of either men or women alone.

SALES BY TYPES OF CUSTOMERS

Type of Customer	Weekdays			Saturdays		
	% of Customers	% of Sales	Average Purchase	% of Customers	% of Sales	Average Purchase
Men...............	28.1%	24.8%	$0.98	26.5%	22.3%	$1.83
Women............	58.2	57.5	1.10	49.3	46.3	2.02
Couples............	6.3	14.9	2.60	21.0	30.4	3.48
Children...........	7.4	2.8	0.43	3.2	1.0	0.69

Basis: 7,584 customer interviews in 8 Crescent supermarkets.

(7) Saturday sales account for more than 50% of the weekly volume.

DISTRIBUTION OF SALES BY DAYS

Type of Store	Percentage of Weekly Sales					
	Mon.	Tues.	Wed.	Thurs.	Fri.	Sat.
Drive-ins*.........	7.5%	9.1%	9.1%	8.7%	15.5%	50.1%
Supermarkets*.....	7.7	8.4	8.4	9.9	23.6	42.0
Supermarkets†.....	6.3	7.8	4.3	10.7	17.7	53.2

* Stores open all day Wednesday, and weekday evenings.
† Stores closed Wednesday afternoon, and weekdays after 6 p.m.
Basis: Sales records, partly Crescent, partly other.

(8) Supermarkets which are located at the peripheries of adjacent trading areas draw more than 80% of their trade from beyond the half-mile zone.

SALES BY TYPES OF LOCATION BY DISTANCE

Zone	Percentage of Sales in Typical Crescent Supermarkets			Average Percentage of Sales in 62 Supermarkets
	Typical Peripheral Location	Typical Major Shopping Locality	Typical Neighborhood Location	
Less than ¼ Mile	9.2%	18.6%	53.5%	26%
¼–½ Mile	6.3	26.2	20.4	22
½–¾ Mile	4.5	14.5	5.8	12
¾–1 Mile	4.0	4.1	3.5	8
Beyond 1 Mile	7.6	9.4	3.0	17
Out of Town	68.4	27.2	13.8	15
Percentage of Customers Who Ride	82.7%	40.7%	43.0%	55%

Basis: 56,217 customer interviews in Crescent supermarkets and in others.

(9) Convenience, price, and quality, in that order, are the determining factors in store patronage.

REASONS FOR BUYING AT STORE PATRONIZED

Reason	Pittsburgh, Pa.*	Philadelphia, Pa.*	Newark, N.J.*	Jamaica, L.I., N.Y.*	Baltimore, Md.†	Wilmington, Del.†	Albany, N.Y.†
Convenience	20.8%	27.6%	19.1%	25.6%	47.6%	29.2%	40.7%
Price	21.1	25.7	21.4	23.8	40.2	25.8	35.8
Quality	23.1	21.8	18.7	15.9	36.2	21.2	42.9
Pesonnel and Service	12.9	8.5	6.4	11.8	29.0	22.0	18.1
Delivery	8.7	....	....	3.9	3.0	4.5	7.7
Credit	3.7	....	9.7	5.8	4.5	11.1	6.6
Friends	....	....	....	13.2	10.4	5.4	3.5
Miscellaneous	3.2	9.7	5.1	....	23.7	3.6	12.3
No Reason Given	6.5	6.7	19.6				
	100.0%	100.0%	100.0%	100.0%			

* Only one reason tabulated for each interview.
† All reasons given tabulated for each interview.
Basis: Customer interviews, partly Crescent, partly other.

(10) The drawing power of a store varies with the type of location.

(11) The percentage of "pick-up" trade is higher on weekdays than on Saturdays and varies with the type of location.

CONCLUSION

After reviewing these findings in relation to the Crescent Company's type of supermarket operation, the market research division believes that the following conclusions are indicated:

(1) The war measures relative to automobiles, tires, and gasoline will not have any serious effect on the supermarket volume of the company during 1942.

(2) There will be shifts in patronage from one supermarket to another without affecting the volume of the company as a whole. Customers who have been buying in one market may choose another one nearer home; but in the interchange the trade that we may lose to competitors is likely to be balanced by the trade that we should gain from them.

(3) Supermarkets with their self-service features are so generally accepted by the food-buying public that it will take more than transportation difficulties to shift customers back to patronizing small neighborhood stores.

(4) Even after 1942, the sales volume of the supermarkets of the Crescent Company will not be seriously affected.

(*a*) Thirty-three of the company's supermarkets are essentially neighborhood stores drawing 70% of their trade from within the half-mile zone.

(*b*) Thirty of the company's supermarkets which are located in major shopping localities and downtown business centers draw roughly 50% of their trade from beyond the half-mile zone. This fact might seem to indicate that these stores will lose approximately 50% of their volume; but this will not be the case, since people will still have to travel to these centers for other needs, such as clothing, house furnishings, beauty treatments, medical care, and the like, and will plan to make their food purchases on such trips.

(*c*) In order to guard against loss of volume in these locations it might be wise to remain open certain evenings, especially since shopping in couples may become more important as the use of automobiles diminishes.

(5) Two of the company's stores are located at the peripheries of adjacent trading areas and draw more than 80% of their volume from beyond the half-mile zone. These units are the two largest-volume stores in the company's organization and are bound to be seriously affected by the restricted use of automobiles. To meet the problem presented by these two stores, the following possibilities should be considered:

(*a*) The addition of new lines, directly or by the leasing of concessions, such as clothing, shoes, house furnishings, hardware, and so on, with a view to building up a complete shopping center under one roof.

(*b*) The sublease of a substantial part of the space either to some noncompeting retail establishment, such as a florist, or to some manufacturer or wholesaler in need of additional warehouse space.

(*c*) Discontinuance of the business in these locations, in the event that the government or some large manufacturer or wholesaler is willing to take over the entire lease, and a simultaneous effort to develop new sales volume by converting some of the remaining 160 neighborhood stores into supermarkets or by taking over some advantageously located automobile showrooms to operate as supermarkets, in either case using the equipment from the two existing large supermarkets.

What action should the management have taken on the report of the market research division?

4. THE CO-OP STORE

GIVING DELIVERY SERVICE

In the middle of March, 1940, the general manager of The Co-op Store, located in Cambridge, Massachusetts, had stopped making deliveries in Arlington, a near-by community, because of the small volume of business from customers in that town. Soon afterward, however, he received two large orders from customers who wanted the merchandise delivered; and he agreed to resume the service. He realized, nevertheless, that the company's policy could not be constantly readjusted to particular circumstances which might arise from week to week; and he decided that the whole question of delivery should be reconsidered and a definite policy established.

The Co-op Store had been organized in 1936 by a church group in Cambridge. People outside the original church group soon became interested in the organization, and by the spring of 1939 there were 280 members. The enthusiasm of the members began to wane during the year, however, partly because of the poor location of the store on a back street some distance from the houses of a majority of the members, partly because of the lack of dividends, and partly because of small sales volume of the store, which permitted only a very limited stock of merchandise to be carried. As a result, the sales of the store for that year amounted to an average of only $330 a week. It was recognized that some definite action should be taken to improve the organization, and one of the members suggested that the directors ask the Consumer Distribution Corporation to investigate and make recommendations.

The Consumer Distribution Corporation, an organization with headquarters in New York, had been founded in 1936 by the late

E. A. Filene for the purpose of promoting the growth of cooperative department stores. The president of the corporation believed, however, that, before such department stores could be started, the urban population should be more widely educated to the cooperative movement. He was of the opinion that, if cooperative food stores could compete successfully with efficient chain food stores, consumers would be convinced of the essential soundness of the movement and there would be less risk involved in providing the larger amount of capital needed for establishing a cooperative department store. The corporation aided the cooperative movement not only by furnishing valuable information to groups wishing to start an organization but also by offering financial assistance and suggestions for improving the operating technique of a store. Toward this end the corporation conducted a training school for store managers. In 1937 it undertook the organization and initial management of the retail stores in the U.S. Government Housing Project at Greenbelt, Maryland. It supplied the capital for inventory and equipment; but as the members of the cooperative subscribed by buying stock, the Consumer Distribution Corporation was repaid, and complete control of the Greenbelt stores was turned over to the members in January, 1940.

After investigating the situation in Cambridge, a representative of the Consumer Distribution Corporation recommended to the board of directors of The Co-op Store that a drive for membership be started in order to raise additional capital. He also recommended that arrangements be made to establish a modern self-service store in a location nearer the homes of a majority of the members. Accordingly, in September, 1939, the organization endeavored to acquire new members in the area north of Harvard Square, where most of the original members lived. Within two months 150 people had joined, and capital of $2,500 had been raised. Shares were sold at $5 each to both new members and old, with no restriction as to the number held, although each individual had but one vote no matter how many shares he owned. In securing new members, the organization stressed not only the advantages of a cooperative store but also the fact that the new store would be a convenient place to buy groceries of good quality at low prices. Nearly all the members, both old and new, were of the white-collar class and were eager to buy good merchandise at the best prices possible.

Early in December a store was selected by the Consumer Distribution Corporation representative in a small shopping area on one of the main streets of Cambridge. Within a block of the new store were located the stores of two corporate grocery chains and one voluntary grocery chain, as well as a large Sears Roebuck retail store. Since none of the grocery stores was self-service, however, the representative believed that the new store would not be undersold by any store in the area. The $2,500 in new capital and an advance of $2,500 from the Consumer Distribution Corporation were used to install modern fixtures in the store and to obtain an initial stock of merchandise from Eastern Cooperative Wholesale, Inc.

Eastern Cooperative Wholesale, Inc., with principal offices in New York, had established a warehouse in Boston in 1936 to serve the member stores in the New England area. These member stores were its only customers. The warehouse was located on a railroad siding in East Boston at a considerable distance from the market district of the city. The growth of the Boston division of the company had been very rapid, and by 1940 it was serving 75 members and expected to sell a total of $1,500,000 worth of merchandise during the year. Sales during the preceding four years had been as follows: 1936, $200,000; 1937, $500,000; 1938, $700,000; 1939, $1,000,000.

Eastern Cooperative Wholesale, Inc., was owned by its members, who had purchased a minimum of $50 in stock in the company and agreed to allow their dividends to accrue until such time as the directors decided that the capital of the company was adequate. The maximum number of shares which a member could own was based on the volume of business done with the company. The voting for directors, however, was on the basis of the number of consumer members who patronized each store; a store was given one vote plus an additional vote for every 500 members.

The wholesale company sold chiefly groceries, since 70 of its 75 customers were grocery stores; but about 10% of its net sales consisted of nongrocery merchandise, such as tires, refrigerators, and vacuum cleaners. Most of the grocery and nongrocery items carried the brand name CO-OP, since the management believed that one of the best ways to develop a group of loyal customers was to offer a single brand name on all the merchandise in the store and

maintain the quality of all products thus branded. The brand name CO-OP had been secured originally from a large midwestern cooperative wholesaler in 1936, and 150 products had been obtained at once from the manufacturers making the branded goods for the midwestern wholesaler. By 1940, 600 items were being sold under the cooperative label; and only about 100 minor items, including 40 duplicates of CO-OP brand articles such as desserts, spices, and soap, were sold under manufacturers' labels. The cooperative retail stores were not compelled to buy the cooperative brand; but most of the new stores used it almost exclusively, while the older stores were content gradually to shift customers away from the national brands to which they were accustomed.

The New York office did all the buying for the Boston warehouse. In fact, the warehouse was not even required to place an order, since the stock control records of the warehouse were kept in the New York office; when the inventory of a certain item reached a previously determined minimum, that office placed the order for shipment to the warehouse. The minimum reorder point was determined by the Boston manager; and if he believed that a certain item might be sold out in spite of the current minimum, he notified the New York office to advance the reorder point.

The prices of Eastern Cooperative Wholesale, Inc., were approximately the same as the cash-and-carry wholesalers' prices in that city, except that about 2% was added to cover the cost of delivery in the area within 50 miles of the warehouse. For the members situated more than 50 miles away the delivery charge was deducted from the price, and the customer paid the freight charge on a public carrier. Deliveries were made on a regular schedule, which was so arranged that one of the company's two trucks covered each section of the territory at least once a week. The total expenses of the Boston organization, in addition to the delivery expenses, amounted to about 6% of net sales; two-thirds of this figure consisted of direct expenditures in connection with maintaining the Boston warehouse and office, and one-third was the company's contribution toward the operating expenses of the New York office.

The usual procedure of a member retailer in buying merchandise from Eastern Cooperative Wholesale, Inc., was to mail an order each week for all the groceries needed during the following week. Since the company operated on a cash basis, it expected a check for the exact amount to be included with each order. A member deter-

mined the amount due by referring to the price list furnished at regular intervals by the wholesaler. In the event that it was necessary to order by telephone, the merchandise was delivered on a C.O.D. basis unless credit arrangements had previously been made. A seven-day extension of credit was available to members up to the amount of money which they had invested in the stock of the wholesale company.

The wholesale company did very little promotional work to increase its members' volume of business. It published a monthly paper, however, which was distributed both by mail and through the stores to persons interested in cooperative principles. This paper, although essentially an educational medium, generally attempted to feature certain products sold by the member stores. In addition to the paper, the wholesale company put out flyers once a month featuring a special sale in the member stores, and made available window cards and displays which the members could purchase.

After the initial stock of groceries had been delivered to The Co-op Store, meats and produce were purchased from the public market in Boston; and the store was opened on December 20, 1939. Sales for the first four days amounted to $1,200. The volume rose almost continuously at the rate of $100 to $125 a week until, during the week before Easter, March 18 through 23, it reached a total of $2,396. Of this total, produce, including $50 worth of Easter lilies, amounted to $495; meats, including $50 worth of Birds Eye products, amounted to $750; and groceries amounted to $1,151. The store expense rate, which during the first seven weeks of operation had amounted to 21% of net sales, dropped to 18% during the month of February. In the same period, however, the gross margin also dropped from 21.5% to 18%, largely because the margin on meats was only 16% instead of the expected 25% and the margin on produce was 25% instead of the expected 28%. Dollar figures for sales, gross margin, and expenses for March, 1940, were as shown in Exhibit 1.

The management of the Consumer Distribution Corporation was of the opinion that the expenses of the store should be lowered to 15% of net sales and the gross margin held at 21%. The store manager believed that he could cut the expense rate down to 16% while maintaining a gross margin of 21%, but he pointed out that the store could not hope to keep up its volume during the summer,

since many of its regular customers moved out of the city at that time.

During the period following the opening, the store had gained a number of customers who were interested in the cooperative nature of the store; but the bulk of the new customers were people who had

Exhibit 1
The Co-op Store
Operating Results for March, 1940

Sales:		
Groceries	$4,389.94	
Meats	2,820.90	
Produce	1,752.38	
	$8,963.22	
Gross Margin:		
Groceries	$ 838.48	
Meats	558.40	
Produce	474.43	$1,871.31
Expenses:		
Manager's Salary	$ 160.40	
Other Salaries (meat manager, second meatman, produce man, checker, and stock boy)	545.29	
Bookkeeping	52.00	
Delivery	139.65	
Pay Roll Taxes	21.81	
Advertising	32.80	
Store Supplies (including $30 for a year's supply of cash register paper)	74.11	
Depreciation on Fixtures	48.00	
Notes	18.00	
Laundry	24.48	
Office	47.96	
Telephone	20.86	
Rent*	179.26	
Amortization of Leasehold†	39.40	
Heat, Light, Ice, and Power	68.31	
Amortization of Expense of Organization	29.40	
Interest on Note	9.60	
Maintenance (including rental of Birds Eye refrigeration equipment)	33.78	1,545.11
Net Operating Income		$ 326.20

* Fixed in rental contract at 2 % of net sales with a minimum payment of $100 a month.
† Expense of remodeling the store and installing refrigeration equipment amortized over a two-year period.

dropped in because the store appeared to be an attractive place to shop and had come back because they found the service and prices satisfactory. A majority of the members lived in the section of Cambridge near the store, but some came from near-by towns. The manager believed that delivery service should be available for the more distant customers, as well as for those living in Cambridge, because many of them were accustomed to this service and would not patronize the store if they could not telephone orders and have

them delivered. In March, 1940, the plan in operation was to give delivery service twice a day to all Cambridge and once a week to Arlington, Newton, and Brookline. For orders amounting to less than $1, a delivery charge of 10 cents was made. The manager of Eastern Cooperative Wholesale, Inc., had recommended that The Co-op Store adopt a plan somewhat similar to the one used by his company. He suggested that the city of Cambridge might be divided into six sections with delivery once or twice a week to each section. He pointed out that the number of deliveries per customer would be reduced and that consequently the size of each order would be increased. It was estimated that, as a result of the fewer deliveries and a more systematic routing, the store would need to employ a man only half time in place of the full-time deliveryman, who received a salary of $17 a week. (A breakdown of delivery expense was as shown in Exhibit 2.) The store manager contended, however, that the type of customer to whom The Co-op Store was appealing wanted more frequent delivery than once a week and that it would be false economy to curtail delivery expense in this way. He pointed out that the store would lose business as well as goodwill since almost all the deliveries were in response to telephone orders. In fact, during the first four days of the

EXHIBIT 2
THE CO-OP STORE
Breakdown of Delivery Expense, March, 1940

Notes	$ 7.12
Taxes	2.72
Driver's Salary	68.00
Boy's Wages	20.00
Gasoline	18.65
Rent	4.00
Repairs	1.00
Depreciation	18.16
Total	$139.65

week, not more than four or five people a day called at the store and asked to have their orders delivered; and even though these requests were more numerous on Friday and Saturday, they were still a small part of the 1,500 to 1,600 orders handled weekly.

Under the delivery system in use, the one light truck left the store at 9:30 in the morning and again at 2:30 in the afternoon. Orders had to be received at the store 15 minutes before the morning delivery and half an hour before the afternoon delivery. In addition to the deliveries made by the truck (see Exhibit 3), a boy,

who was employed on a part-time basis, delivered about 25 orders on Friday afternoon and 50 orders on Saturday to customers living near the store. The manager believed that the average customer ordered three times a week. He estimated that the 50 to 60 orders which the truck delivered every day in Cambridge had an average value of about $2 to $3 each and that the 5 or 6 orders delivered on Thursday to Newton customers and the 7 or 8 orders delivered on Friday to Brookline customers averaged $8 to $10 each. The store had only three or four members living in Arlington, and the orders from this section had been very irregular. In fact, for the delivery

EXHIBIT 3
THE CO-OP STORE
Miles Traveled and Number of Deliveries per Day, Week Ending March 30, 1940

	Miles Traveled	Number of Deliveries
Monday	36	51
Tuesday	33	63
Wednesday	32	60
Thursday (Newton)	57	42
Friday (Brookline)	47	50
Saturday	37	55
Total	242	321*

* Not including 75 deliveries by boy on Friday and Saturday.

which was to have been made on March 12, only one order amounting to $1.30 had been received. The manager called the woman who had placed the order, described the situation to her, and said that the store was discontinuing delivery service to Arlington. The woman apparently thought that this decision was reasonable and canceled her order. During the week, however, another member living in Arlington called the store and told the manager that, if he would make delivery to Arlington, she would give him a $20 grocery order and her daughter would place another order of approximately the same size. The manager felt that the store could not refuse this business, and he agreed to make a delivery to Arlington on March 19.

To what extent should the management of The Co-op Store have offered delivery service?

What appraisal of the consumer cooperative movement in the United States should have been made by the managements of such concerns as the Dever Company (page 579) and the Atlas Wholesale Grocery Company (page 595)?

5. EASTERN BLANKET COMPANY

SALES TO BUYING SYNDICATES

The Eastern Blanket Company was a large producer of medium-grade and low-grade cotton and cotton-and-wool blankets, which were sold nationally under the "Eastern" brand name. In 1930 the usual retail prices of the main line varied from below \$1 to over \$5. A fairly typical price was \$3 per pair.

In the fall of 1930, largely at the insistence of an organized group, the wholesalers for the Eastern Blanket Company threatened to discontinue stocking the company's line of blankets during 1931 if the company sold to retailers' buying syndicates at wholesalers' buying prices for blankets.

The selling prices of the Eastern Blanket Company were based on estimates of competitive influences and on the attitude of customers. The company established selling prices from which wholesalers received a 2½% discount on individual orders of less than 100 cases; on orders of 100 cases or more, the wholesalers received a 5½% discount. Individual retailers buying 100 cases or more at a time paid list prices less 5½%. During the year 1930, buying syndicates received the same prices as wholesalers for similar quantities. It was against this practice that the wholesalers protested; they expressed no opposition to the company's policy of selling direct to large retailers.

The term "buying syndicate" was used by the company to denote both resident buyers and buying groups, which in the preceding 10 years had come to be a considerable factor in retail buying. Resident buyers, often former buyers for department stores, acted as the New York representatives of department stores which, usually because of their small volume of business, did not maintain buyers and offices in the New York market. Each resident buyer represented from a few to several hundred stores, generally scattered throughout the country. The New York resi-

dent buying office placed orders at the request of the stores, but such orders usually were shipped and billed direct to the individual stores. Resident buyers commonly operated on an annual fee basis. In addition to acting as resident buyers, these men frequently formed buying groups among the stores which they represented. The purpose of these groups was to buy specific items of merchandise at reduced prices. Wholesaling was a third function performed by some resident buyers; these buyers ordered merchandise on their own account, carried stocks, and sold to retail stores.

Buying groups were set up differently from resident buying organizations. The usual practice was for a group of affiliated stores to establish a New York office with a group manager in charge of several market specialists. The departmental buyers, or managers, in the individual stores retained substantial freedom in the buying of their merchandise requirements. Styles and product lines were selected at a general meeting of buyers from the member stores or by a small committee of buyers. The individual buyers then ordered as they chose from the selected styles and lines of merchandise. Member stores placed orders direct with the manufacturer if the latter agreed to give lowest wholesale prices on such orders. In some cases the individual orders were pooled to obtain wholesale prices. The groups generally aimed to deal with so-called "preferred resources." In some instances groups carried on "central buying" operations. The general practice was to have orders delivered and billed direct to the individual stores, although some orders were billed to the New York offices, which then became responsible for collection.

Buying groups were composed of 4 to 80 member stores, the average group including between 35 and 50. Most department stores with annual sales of $1,000,000 or over belonged to one or more buying groups. Many smaller stores likewise were members. Department store buying groups, consisting of both "ownership" groups and "affiliated" groups, represented a much larger volume of sales than did resident buyers.

The Eastern Blanket Company had annual sales of several million dollars. Sales to wholesalers had accounted for over half the total in 1928; but by 1930, wholesalers were responsible for only 36% of sales. Much of the remainder went to chains and large institutional buyers, mostly under private brands. Some sales were made to large department stores direct. On 50% of its sales

to wholesalers the company made drop shipments; that is, it shipped the merchandise to the retail customers of the wholesalers but billed the latter for the shipments. The management attributed the decline in sales to wholesalers to changes in distribution which were said to have affected adversely the business of wholesalers generally (see Appendix).

Sales of Eastern blankets to buying syndicates had amounted to a small proportion of total sales but had been increasing each year. Sales direct to department stores also were increasing and in 1930 had been roughly four times the sales to syndicates.

While considering what action to take, the officials assembled the following notes on the activities of particular syndicates:

Syndicate A, with a permanent membership of 18 stores, was essentially a buying group. Large manufacturers typically sold direct to all the members of this syndicate. The buyers for numerous departments of the member stores, however, met at the syndicate office in New York at the beginning of each season. At these meetings the syndicate managers offered for group approval a selection of lines from representative manufacturers. Store buyers, acting as a committee, made selections from these offerings. The syndicate office was supported by the fees charged to members. Manufacturers were not expected to furnish samples to individual stores. Billing of merchandise was either through the syndicate or direct to the stores, at the option of the members. Syndicate A had separate market representatives for each major line of merchandise.

Syndicate B, representing 83 small stores whose members typically did not purchase direct from manufacturers, maintained a New York office. This syndicate had no sample requirements; billing of all shipments was made to the syndicate in order that the syndicate might charge a slight markup to members to cover the cost of doing business. Shipments of merchandise, however, were made to the individual stores. Orders generally were not pooled for members but came to manufacturers for delivery in small quantities to the various stores.

Syndicate C, known in the trade as a resident buyer, represented a varying number of stores, from 121 to slightly over 200, 18 of which were large enough to be sold direct by many manufacturers. This organization required no samples to submit to members. Bills were sent to the syndicate, which, in turn, charged a 5% to 7% markup to members. This organization maintained a wholesale department for staple items. One manufacturer handling staple lines of merchandise reported that Syndicate C pooled orders on staple commodities for which there was a slight seasonal demand. A second manufacturer stated that pooling of orders for staple merchandise was more frequent than for style goods and that, according to his experience, when such pooling occurred the costs of handling the business were negligibly higher than handling the accounts of wholesalers.

The executives did not wish to refuse to sell to syndicates altogether; on the other hand, if the company revived a former policy of charging them 7% to 10% more than the list price to wholesalers, the syndicates presumably would give their orders to competing manufacturers. Although the management believed that buying syndicates were growing in importance, it also considered the goodwill and support of wholesalers important. If the officers acceded to the request of the organized group of wholesalers, the latter were expected to sell Eastern blankets more aggressively.

What action should the management have taken?

Appendix

In February, 1936, J. O. McKinsey, Chairman of the Board of Marshall Field & Company, issued a 45-page brochure to the employees of the company, explaining why the company had given up its wholesale division, and outlining some of the plans for the reorganization of the manufacturing division of the company. Extracts from that statement follow.[1]

I. Trends in Consumer Buying Habits

A. increased interest in style

"The interest in style has increased to an unusual degree during recent years. The consuming public has become style conscious to an almost unbelievable degree. The buyer of every type of commodity insists that it be in harmony with the most recent style change in that particular field. Whether it be hosiery for the infant or house slippers for the aged, the product must be in accordance with the dictates of fashion.

. . . .

"Through motion pictures, periodicals, and the radio, the public is educated continuously with reference to new product styles. The consumer sees the latest style worn by her favorite actresses, hears of the latest products in the persuasive voice of the radio announcer, and sees the latest creations of art in the magazines and newspapers which come to her easy chair.

"In 1922, weekly motion-picture attendance was approximately 40,000,000. In 1930, more than 100,000,000 people attended motion-

[1] Editor's note: The numbers and letters of the outline have been added.

picture theaters weekly. The first official radio broadcast was in 1920. By 1923 there were approximately 1,500,000 radios, and it is estimated that there are now approximately 20,000,000 radios in use, or nearly one for every family in the country. Periodical circulation has increased rapidly since 1920. The circulation of the six leading women's magazines, each of which features style news, increased from 7,278,000 in 1920 to 13,668,000 in 1934.

"Within a few weeks the entire population of the country has an opportunity to see the same styles pictured on the screen, in the magazines and newspapers, and to hear them discussed over the radio. More recently style photographs have been flashed from country to country and from one part of the nation to another by means of radio and telegraph. The consumer has become more and more style conscious because of constant exposure to style through these means.

. . . .

"Production facilities in many lines of industry were greatly expanded during the World War. This was particularly true in the fields producing staple merchandise. After the depression of 1920 and 1921, many of these manufacturers found they had excess production capacity.

"A few of them seized upon the increased tempo of living and the new habits and modes to develop merchandise which appealed to these new desires. New styles enabled them to render obsolete, merchandise which had previously been fashionable and to create an accelerated demand for their goods. . . .

"Thus some industries seized upon the prevailing conditions to foster style and fashion influences as a means for solving some of their problems. The various conditions and developments which we have previously discussed made it possible to make rapid headway with this type of merchandising.

"*The major effects of the increased interest in style have been:*

"*It has made seasonal trends less emphatic.* Prior to the War most products which were used throughout the year, such as clothing, were subject to two style changes a year—spring and autumn. During recent years because of the increased interest in style, the style of many products is changed almost month to month. It is rare in the case of fashion articles that the line established at the beginning of the season can be continued throughout the season without change. The manufacturer of such merchandise must be in close contact with the consumer demand so that he can adjust his product quickly to meet this demand. The retailer of style merchandise desires to be in a position where he can present his needs quickly to the producer.

"*Styles have become less exclusive.* A quarter of a century ago a style presented to the public in one part of the country might not become well known to the buying public in another part of the country for six months to one year. For example, the styles in New York did not usually become popular in the Middle West until the next season.

Today a woman in a small town in the Middle West becomes quickly aware of the styles popular in New York or Hollywood simply by attending the neighborhood movie. This condition leads to all classes of people becoming familiar with style trends and results, in turn, in style parity. The manufacturer of lower priced products will imitate the style of the higher priced products so as to cater to the style consciousness of those in the lower income brackets. These conditions decrease the exclusiveness of any particular style and in turn require the creation of additional styles to satisfy those who do not desire to use that which is being used by all classes of the consuming trade.

"*It leads the consumer to seek trade centers where she can have a greater choice of styles, and it leads the retailer to seek style centers so he may have closer contact with style creators.* The housewife is not content to view the styles in the small general store located in the rural village. She desires to see the styles in a number of stores in the trade center 50 miles away. The retailer in the trade center in order to cater to the desires of the housewife prefers to deal directly with the manufacturer who is creating styles.

B. INCREASED DEMAND FOR LOWER PRICES

"There is a continuing demand for lower prices on the part of the consumer. The effectiveness of this demand depends upon the stage of the business cycle and the conditions affecting each specific product.

. . . .

"The major effects of the demand for lower prices have been the following:

"There has been an increased tendency for the consumer to shop to secure lower prices, and this has led him to go to trading centers where such shopping is possible.

"It has led the consumer to patronize stores which purchase in sufficiently large volume to enable them to obtain price concessions from the manufacturer, which in turn they can pass on to the consumer.

C. INCREASED TENDENCY TO SHOP IN TRADING CENTERS[1]

"There is substantial evidence to show that there has been an increasing tendency for consumers to buy in the larger trading centers. Studies based on the 1930 Census show that 93 metropolitan markets, containing approximately 47% of the country's population, sell nearly 62% of the total merchandise sold at retail. The significance of these metropolitan markets in the sale of various types of merchandise is shown by the following data:

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[1] "It is somewhat difficult to define what constitutes a trading center. In the South and Northwest it may mean a town of 2,500 population or more. In the eastern states it usually means a town of 5,000 or more. In some sections there are few towns of less than 10,000 population which can be regarded as such centers."

Importance of 93 Metropolitan Markets in the United States
(1933 Data)

	Percentage of Total Retail Stores	Percentage of Total Retail Sales
Grocery	55.8	61.9
Drug	53.4	60.8
Shoe	62.9	75.2
Filling Stations	38.3	48.7
Department—General Merchandise Variety	40.7	65.6
Total Retail	51.2	61.1

"These data show that 40.7% of the merchandising stores of the United States are located in these 93 metropolitan markets, but that these stores sell 65.6% of the merchandise sold at retail.

"The Census of Distribution for 1929 shows that retail sales in towns of 10,000 and less aggregated nearly $15,000,000,000, or approximately 31% of total sales. Approximately 20% of these sales, however, were made in towns which lie within the boundaries of the 93 metropolitan markets. This means that approximately $12,000,000,000, or only 25% of total retail sales in 1929, were made in towns of 10,000 or less, which were not part of metropolitan markets. These data show the extreme importance of the larger marketing centers.

"A recent survey shows that the county-seat type of town of 10,000 population or more is drawing an increasing proportion of the total business outside of the metropolitan districts. Even the county-seat type of town is losing a considerable amount of its former business to the cities of 25,000 to 75,000 population.

. . . .

"Studies indicate a continuation of the trend to buy in larger centers. The major reasons for this trend are the following:

"(1). The influence of the conditions we have previously discussed, namely:

a. Increased interest in style.

b. Increased demand for lower prices.

"(2) Improved transportation which makes it easier to reach the trading center.

"(3) The shift in population. Since 1900 the increase in urban population has been as follows:

Percentage of Population in Cities of 8,000 or More

1900	32.9
1910	38.7
1920	43.8
1930	49.1

With the greater number of people living in cities, it is natural that the amount of purchasing done in these centers would increase.

"The major effects of the increasing trend to buy in trading centers are the following:

"(1) The shifting of trade from the village store to the trading center. Thousands of small dry-goods stores in the small villages have gone out of business during the past quarter of a century. Many of those now remaining are in poor financial condition and handle only a limited line of low-grade merchandise.

"(2) The shift of trade from the small county-seat town to the larger cities.

"(3) The development of larger retail units such as department stores, and of the merchandising chains.

"(4) Greater division of activities in the retail units and the appointment of special buyers for different commodities.

D. INCREASED BUYING FROM CHAINS

"The growth of the chain store has been one of the outstanding developments in the merchandising field during the past quarter of a century. Chains handling all types of merchandise have experienced rapid growth. It is estimated that in 1914 there were approximately 2,000 parent companies operating three or more units, with a total of approximately 23,893 units, and sales of not over $1,000,000,000. The 1930 Census showed approximately 7,000 companies with 159,826 store units which had total sales in 1929 of nearly $11,000,000,000. The growth of these chains in the merchandise and apparel industry has been comparable with that of the chain store industry as a whole. The reasons for the growing retail sales in trading centers have been stated in our previous discussion. This, in turn, has tended to produce an increase in buying from the chains.

"The major effects of the increasing trend to buy from chains are the following: It has drawn more people into trading centers; . . . it has increased the tendency for goods to flow directly from the manufacturer to the retailer.

. . . .

II. Trends in Retail Buying Methods

"In the previous chapter, we saw an increasing tendency for the consumer to purchase in trading centers and to purchase from the larger retail units and chain stores in these centers.

"As a consequence of this tendency, the small retailer has decreased in importance in the sale of quality merchandise to the consumer. Thousands of these small retailers have ceased to operate, and those remaining handle primarily low priced staple merchandise which they sell in limited quantities and buy in very small units. Their needs are supplied in large part by the local jobber. These retailers are consequently of little significance to the national jobber.

"In our present consideration of retail buying methods, therefore, we are concerned only with the retail units in trading centers and in metropolitan markets. Furthermore, except for insignificant purchases, the large retail units obtain their merchandise direct from the manufacturer. The amount purchased from other sources is not of sufficient volume to merit consideration by the national jobber of quality merchandise. The following discussion, therefore, is concerned with the buying methods of retail stores in trading centers and metropolitan markets.

"These retail stores buy primarily in the following ways:

1. Direct from manufacturer.
2. Through cooperative buying associations.
3. Through buying offices.
4. From wholesalers.

"In the following discussion we shall endeavor to determine the extent to which these retail units use each of these methods and the probable trend in the amount purchased from each source.

A. DIRECT PURCHASING FROM THE MANUFACTURER

"Retailers in trading centers and metropolitan markets have increased their purchases direct from the manufacturer to a material degree during the past 25 years. The reasons for this increase are the following:

"Retailers believe that the manufacturer will provide them a wider variety and a better choice of style merchandise than the wholesaler. The manufacturer usually specializes in one line of merchandise and seeks to provide a complete line of products. He usually presents to the retailer a more complete line than the jobber who selects from the manufacturer's stock those items which he thinks will sell more readily.

"Retailers believe they are more likely to be protected from local competition when they purchase from the manufacturer. The manufacturer will frequently restrict his sales in a town to one retailer if this retailer provides him a satisfactory distribution, whereas the jobber follows the general policy of seeking to secure extensive distribution in each town.

"Retailers believe they can secure better service from the manufacturer since he is organized to render specialized service with reference to the product he produces, whereas the jobber selling a wide variety of products to a much wider variety of customers is not so well organized to give specialized service on a specific product.

"Retailers believe they can secure merchandise from the manufacturer at a lower price than it can be secured from the wholesaler since this method of buying eliminates some of the expense incurred by the wholesaler.

"Retailers in trading centers and metropolitan markets purchase nearly all kinds of merchandise from the manufacturer. The most frequent exceptions to this general rule are the following:

"(1) Millinery. A considerable amount of this product is purchased from specialty jobbers.

"(2) Notions. These products are purchased frequently from general line jobbers.

"(3) Toiletries. These products are purchased frequently from drug jobbers and specialty jobbers.

"The extent to which merchandise is purchased direct varies according to territories, size of cities, size of stores, and types of stores. There is more direct buying in the eastern half of the United States than in the territory west of the Mississippi. Direct buying usually increases with the size of the city and with the size of the store. Specialty stores usually buy a larger percentage of their requirements direct than do general stores. The extent of such buying may be summarized as follows:[1]

"Even in the smallest towns in all parts of the country a few lines are purchased direct from the manufacturer. In nontrading centers we estimate that approximately 25% of the total purchases are made in this manner.

"In towns of from 3,000 to 15,000 population the leading stores on an average buy nearly 50% of their requirements direct.

"In towns of from 15,000 to 100,000 population leading stores on an average buy more than 50% of their merchandise direct.

"Retailers whose annual sales volume is between $250,000 and $1,000,000 purchase 75% of their requirements direct.

"Retailers purchasing more than $1,000,000 per year buy on an average 90% of their merchandise direct from the manufacturer.

"There is no reason why the amount purchased direct from the manufacturer will decrease in the near future. In fact, an improvement in conditions will likely result in an increase in the amount purchased from this source since many stores which do not now buy in sufficient quantities to enable them to deal with the manufacturer will be able to do so if their volume of sales increases. Another reason for the continuance of this practice is that it is favored by the manufacturer as well as the retailer. The manufacturer believes that direct buying on the part of the retailer is advantageous to him for the following reasons:

"It enables him to keep in close touch with the style demands of the consumer.

"It enables him to promote the sale of his products aggressively since he has a sales organization specializing in these specific products.

"It enables him to exercise a more effective control over the resale prices of his merchandise.

"It enables him to have direct contact with a large number of retailers and gives him better control of his market than if he is dis-

"[1] 'Direct buying' as used in this discussion does not include the merchandise purchased through buying associations. It duplicates in some cases the merchandise purchased through buying agents."

tributing through only a few jobbers who may change to other products for a variety of reasons.

B. COOPERATIVE BUYING ASSOCIATIONS

"Cooperative buying associations are of various types. They usually consist of independent department stores who have merged their buying efforts. The association usually establishes a central organization in New York City. This organization is often a separately incorporated company which carries on one or more of the following activities:

(1) Research.
(2) Styling.
(3) Establishment of uniform accounting methods.
(4) Collection and distribution of operating data.
(5) Personnel work.
(6) Central buying.

"The buying organization usually consists of specialists in each line of merchandise. The specialists perform the following activities:

(1) Assist store buyers on their trips to the New York market.
(2) Buy for the store buyer when he is not in the market.
(3) Pool the buying orders of several units where large volume can be used to obtain price concessions, discounts, or advertising allowances.

"It is estimated that the stores which are members of the buying associations have an annual volume of more than one billion dollars. The amount of their total requirements which different stores purchase through these associations varies to a considerable degree. The importance of this method of retail buying is indicated by the following:

"There is only a limited number of large department stores which are not associated with some kind of a buying association. In several of the most important metropolitan markets many of the stores doing the largest volume of business are members of buying associations. For example, in Boston, six of the eight largest department and specialty stores are members of these associations. The other two are members of a department store chain.

"The buying associations represent stores located in all sections of the country. For the most part, however, their members are confined to cities having a population of 75,000 or more. Stores in the smaller cities utilize the services of buying offices instead of using buying associations.

"A recent survey indicated a tendency for the importance of buying associations to increase. Most of the retailers interviewed stated that these associations were useful to them, especially in the purchasing of staple merchandise. Some of the larger retailers expressed dissatisfaction with them in the purchasing of style goods.

C. BUYING OFFICES

"The buying offices are companies or individuals who offer the following services to clients on a commercial or fee basis:

(1) Research.
(2) Styling.
(3) Development of selling plans.
(4) Central buying, which:
  a. Assists store buyers on their regular trips to the market.
  b. Buys for the store buyer when he is not in the market.
  c. Pools the orders of various clients to secure a volume in order to obtain price concessions, discounts, advertising allowances, or exclusive style features.

"The larger buying offices have specialists in the various lines of merchandise. For example, one buying office has 35 buyers in its ready-to-wear department and an equal number handle various lines of staple merchandise. Most of the large buying offices are located in New York, where they concentrate upon ready-to-wear merchandise. The larger ones, however, perform a similar service in the purchase of staple merchandise. One of the large offices, for example, purchases several million dollars worth of blankets, towels, sheets, and pillow-cases for its clients each year.

"There are several hundred buying offices in New York City, and these offices have as clients both large and small stores located in towns of all sizes.

"These offices are expanding both in number and in range of activities. There has been a gradual growth in their number during the past 15 years and a very large percentage of all department stores are now represented by buying offices. Even stores of an annual sales volume of $50,000 a year will be represented by buying offices in one or more markets. The significance of these offices is that they provide an additional means of purchasing direct from the manufacturer and, as a consequence, decrease the need for the wholesaler.

"*The Wholesaler.* The development of the buying methods we have discussed has continuously decreased the importance of the wholesaler. It is estimated that the large retailers in trade centers and metropolitan markets purchase an average of 80% of the total merchandise they sell either direct from the manufacturer, through cooperative buying associations, or through buying offices.

. . . .

" . . . The volume purchased by the retailer from the wholesaler has declined rapidly during the past 15 years, as shown by the following table:

SALES BY DRY GOODS WHOLESALERS
(Index Numbers. Monthly Average, 1919 = 100)

1919	100	1927	81
1920	115	1928	78
1921	83	1929	81
1922	83	1930	70
1923	95	1931	63
1924	91	1932	51
1925	91	1933	53
1926	87	1934	56

"There appears to be no reason why the proportion of purchases from the wholesaler will increase. In fact, there are indications that the decline will continue.

"Moreover, the purchases made from the wholesaler consist largely of the following:

(1) Fill-ins.
(2) Small orders.
(3) Products purchased at reduced prices for special sales purposes.

"In other words, the retailer in the trading centers and the metropolitan markets uses the jobber to supply him with the merchandise on which the vendor receives the least profit.

"The retailer in his purchases from jobbers is inclined to use the specialty jobber and the local jobber to a very considerable degree. The larger stores prefer the specialty jobber because the buying in these stores is highly specialized and the buyer prefers to deal with the specialty jobber whom he feels to be better qualified in his specific field than the general jobber. The retailer in many cases prefers the local jobber because he feels he can secure better service from him than from the national jobber on the particular type of merchandise he desires to obtain, especially on fill-ins and small orders.

"Under these conditions the outlook for the *national* jobber of *quality* merchandise is very unsatisfactory. He can no longer sell on a profitable basis to the merchant in a nontrading-center town, and he can expect to secure only a small percentage of the total requirements of the better class of retailers in trading centers and metropolitan markets. Even that percentage which is available to him is not of the type of merchandise which it is most profitable for him to handle.

. . . .

III. The Problem of the Wholesaler of Quality Products in the Merchandising Field

A. An Answer to the Problem

"The discussions in the two previous chapters showed very definite trends in consumer buying habits and in retail buying methods.

Through these, we can now appraise the present condition and outlook for the market in which the *national* jobber of *quality* merchandise endeavors to sell his products. Such an appraisal emphasizes the following conclusions:

"(1) That there has been a rapidly increasing tendency for the consumer to purchase in the trading center and the metropolitan market.

"(2) That, as a result of the former, the merchant in the nontrading center has become increasingly less significant as a means of distributing merchandise.

"(3) That, consequently, a large portion of the former market of the jobber has disappeared. The total purchases of the merchants in nontrading centers are only a small percentage of what they were a half century ago.

"(4) That the important retail outlets in trade centers and metropolitan markets purchase a large percentage of their requirements direct from the manufacturer or through buying associations or buying agencies. Thus they have become increasingly less important as a market for the jobber. It is estimated that on the average they do not purchase more than 20% of their requirements from the jobber and that a considerable percentage of these purchases consist of fill-ins, small orders and special-priced merchandise.

"1. *Position of the Wholesaler*[1] *in Small-town Market.*—The outlook for the wholesaler in the small-town market is not promising for the following reasons:

"(1) This market has decreased very materially in importance during the past 25 years and is now not a significant factor in the distribution of *quality* merchandise.

"This conclusion is substantiated by the records of a representative wholesaler which showed that in a group of towns typical of the small-town market, the number of customers in towns of 3,700 population and less declined 54% between 1921 and 1934.

"Indicating concretely what has taken place in this type of town, which is typical of similar experiences in a large number of towns, is the following example:

"This town had a population of 2,800 in 1929 and 3,100 in 1930, an increase of approximately 10%, while the population of the country during this period increased 16%. In 1921, there were 14 accounts, sales to which aggregated $36,000. In 1934, there were 5 accounts, sales to which aggregated $13,000.

"This decrease was due primarily to stores going out of business or becoming such poor credit risks that they could no longer be sold with safety.

"(2) The products of a national jobber of quality merchandise are not well suited to the needs of most of the small-town markets. The merchants in nontrading centers sell primarily staple merchandise of

"[1] 'Wholesaler' as here used refers to wholesaler, or jobber, operating nationally."

low quality. Most of them do not sell style merchandise and do not sell staples of high quality. The typical small-town merchant does his largest business in such lines as overalls, men's work shirts, cotton wash dresses, piece goods, and notions. These lines are predominantly staple in character and low in price.

"An analysis of departmental sales of a national jobber showed that the largest volume of his business was secured on staple and low-priced merchandise. Sales in towns of 2,500 and less to representative accounts indicated that the greatest volume of sales was in the following departments: hosiery, men's furnishings, percales and ginghams, cotton wash dresses, underwear, nightwear and lingerie, domestics. These departments offer primarily staple and low-priced merchandise.

"In a recent survey small-town merchants gave the following reasons for not buying from national jobbers:

a. Price: Too high.
b. Attitude: High credit requirements and autocratic dealing.
c. Quality: Too high for the trade.
d. Service: Back orders, infrequent calls, slow delivery.
e. Style: Behind the market on style goods.

A number of these retailers stated they would like to handle *quality* merchandise but that their customers would not pay the prices which they must charge for merchandise of this character.

"(3) The local jobber is better equipped to serve this market than the national jobber. The local jobber is securing a very substantial portion of the wholesale business in all those localities where competent local jobbers exist. Retailers gave the following reasons for their use of the local jobber:

"*a.* Service.—The merchants contended the local jobber provided better service than the national jobber for the following reasons:

1. His salesmen called more frequently.
2. Delivery service was more prompt, due to the proximity of the local jobber's warehouse.
3. The merchant could visit the display rooms often and select the merchandise he desired.
4. The products and operations of the local jobber were adapted to meet local conditions.

"*b.* Volume.—Many merchants stated that they were using local jobbers because their volume in dry goods was insufficient to justify the national jobber selling them on a reasonable basis.

"*c.* Price.—In many cases, the small-town merchant believed the local jobber operated more economically than the national jobber and as a consequence gave him goods at lower prices. They also felt that savings could be made in shipping costs in buying small orders from the local jobber.

"*d.* Credit.—The local jobber is better acquainted with the trade than the national jobber and as a consequence will frequently extend

credit to customers to whom credit is refused by the national jobber. This is a more important reason for using the local jobber than the merchant will admit since he usually does not desire to state his financial problem.

"*e.* Local Pride.—Some small-town merchants stated they favored the local jobber because they wished to aid the business houses in their territory.

"From the foregoing it is apparent that the national jobber does not occupy a satisfactory position in the small-town market and that the prospects for improving this condition are not promising.

"2. *Position of the Wholesaler in Trading Centers and the Metropolitan Markets.*—The purchases from the jobber by the better grade of accounts in this market have declined rapidly during the past quarter of a century. The total purchases from this source will not average more than 20% of the total requirements of these accounts. The wholesaler in seeking to sell these accounts as a jobber, therefore, is competing for 20% of the market instead of the 80% which is supplied from other sources.

"The purchases made from the jobber by these accounts are of such a type that most of them are not profitable for a national jobber of quality merchandise to handle. These accounts use the jobber primarily to secure the following:

(1) Fill-ins.
(2) Goods ordered in small quantities.
(3) Goods purchased at low prices for special sales.

"These accounts, to a very large degree, prefer to buy from specialty jobbers and local jobbers rather than from the general national jobber. They prefer to buy from the specialty jobber because they believe these have a wider variety of better styled merchandise than the general jobber. They also believe that the representatives of these companies are better informed on the products they sell. Many of these accounts prefer to buy from the local jobber those items which they do not purchase from the specialty jobber primarily because of the better service they secure from the local jobber in the way of quick deliveries and low transportation costs on small units.

"Because of these conditions the ability of the wholesaler, or national jobber, to profitably serve this market is definitely limited. Furthermore, a company seeking to operate in the dual capacity of a jobber and manufacturer is handicapped in the sale of its products. Buyers in the larger stores are prone to look upon such a company simply as a jobber and as a result of this prejudice give less consideration to its products than to those of other manufacturers.

"3. *Summary of Conclusions on Place of the Wholesaler in the Merchandising Field.*

"(1) That the wholesaler, or national jobber, of quality merchandise, as such term is here used, does not occupy a satisfactory position in the small market for the following reasons:

a. This market has decreased to a very material degree during the past 25 years and, as a consequence, he has been forced to meet increasing competition in a declining market.
b. The products of a national jobber of quality merchandise are not well suited to the needs of most of the merchants in the small-town market.
c. The local jobber is better equipped to serve this market than the national jobber.

"(2) That he does not occupy a satisfactory position as a jobber, as the term is here used, in the trading-center market for the following reasons:

a. The amount which the better grade of retail units in this market purchases from the jobber has declined very rapidly during recent years.
b. The purchases made from the jobber by these accounts are of such a type that most of them are not profitable for a national jobber of quality merchandise to handle.
c. These accounts, to a very large degree, prefer to buy from specialty jobbers and local jobbers rather than from the general national jobber.

"(3) That a company operating in the dual capacity of a jobber of quality merchandise and as a manufacturer does not occupy a satisfactory position in the trading-center and metropolitan market because many buyers, by reason of their prejudice against such a company as a 'jobber,' hesitate to purchase its manufactured products.

B. AN ANSWER TO THE PROBLEM AS IT CONCERNS MARSHALL FIELD & COMPANY

"The foregoing brings us to a discussion of the Wholesale Division of Marshall Field & Company which operated as a wholesaler, or national jobber, also as a manufacturer and importer. The conclusions drawn in this and the previous chapters applied with particular force to the Wholesale Division.

"Under these conditions it was not only desirable but necessary that serious consideration be given to the adoption of the following program which would insure the success of the Wholesale Division in its future operations:

"1. That the Wholesale Division cease to operate as a 'jobber,' thereby discontinuing the sale of products which were purchased from other manufacturers. This meant the elimination of the following lines: 'hard lines,' including jewelry, handbags, toys, hardware, electric accessories, notions, toilet goods, tableware, lamps, clocks, luggage, furniture, linoleums, mattresses, etc. Miscellaneous dry goods, including men's furnishings, women's silk ready-to-wear, batts, comfortables, corsets, women's neckwear, women's beachwear, ribbons, laces, buttons, etc.

"2. That henceforth this Division be known as the MANUFACTURING DIVISION, and that it concentrate upon the sale of goods of its own manufacture, conversion, or exclusive importation. This meant the continued production and distribution solely of textiles (in the broad meaning of the word). In order to insure logical and concentrated sales management we have divided the products into the following groups:

"(1) Cotton and Wool Blankets and Flannels—all types; Bedspreads; Sheetings and Sheets; Table Linens—plain and fancy; Towels and Toweling—plain and fancy.

"(2) Cotton Wash Goods—woven and printed, sheer and coarse, novelty and plain; Rayon and Cotton Wash Goods—same varieties as above; Silk Piece Goods—same varieties as above; Woolen Piece Goods—women's suiting, coatings, dress goods.

"(3) Woven Drapery Fabrics—all types; Lace Curtains and Curtain Nets; Printed Drapery Fabrics—all types; Wilton Rugs and Carpets; Domestic Oriental Rugs.

"(4) Women's Full-Fashioned Hosiery; Children's Hosiery; Men's, Women's, and Children's Knit Underwear.

"(5) Women's and Children's Woven Lingerie and Nightwear; Women's Washable Cotton Frocks.

"(6) Domestic and Imported Gloves for Men, Women, and Children—both fabric and leather; Men's, Women's, and Children's Handkerchiefs.

"3. That the Manufacturing Division will concentrate on selected customers so that every customer we are servicing with our direct distribution plan will mean that he has qualified within the limits that the survey indicated.

"4. That the Manufacturing Division seek aggressively to sell its products in trading centers and metropolitan markets to the following groups of accounts:

(1) Large retailers in trading centers and metropolitan markets either independently or through buying associations or offices.
(2) Mail order houses, chain organizations, jobbers and others who buy in bulk quantities.

"It will be noted that these classes account for approximately 80% of the total retail volume.

"These decisions meant numerous changes in organization, in personnel and in general policies.

"It is natural that in an organization as large as Marshall Field & Company such changes, made as they were in a comparatively short time, should have been attended by much comment and speculation. However, the foregoing will explain many of the things which, to those not familiar with the background of the situation nor aware of the aims being sought, may have seemed unnecessary.

"For the benefit of those who have not visited our mills we might say a few words about them. Our principal manufacturing activities are located in four towns—Spray, Draper and Leaksville, in North Carolina, and Fieldale, Virginia. These towns are all within a radius of 25 miles of each other, so for practical purposes the mills are contiguous. In this area we own at the present time 19 separate mills, employing approximately 7,500 people. The towns are all located in the foothills of the Blue Ridge mountains, and each community is "southernly" picturesque. The mill workers are a contented group, and are well satisfied with the general living accommodations that we have provided for them. While we own and rent to the workers over 2,000 individual houses in this area, the houses are all sufficiently different in construction and appearance to do away with the sameness and ugliness so often encountered in mill communities.

"In the area described in the preceding paragraph, approximately 80% of our manufactured products are produced. Altogether the mills contain approximately 4,000 looms and about 150,000 spindles. In this area are produced all of our blankets, sheets, towels, pillowcases, bedspreads, silk, rayon and wool piece goods, as well as our entire Karastan rug weaving operations, and a part of our hosiery production.

"Other mills and factories owned by Marshall Field & Company, Manufacturing Division, are scattered in different parts of the country. We have a large knit underwear mill in Pawtucket, Rhode Island; a hosiery plant in Philadelphia; a Wilton carpet and rug mill in Philadelphia; a men's underwear plant at Roanoke, Virginia; lace curtain mills at Zion, Illinois; a thread mill at Monticello, Indiana; and a men's shirt factory at Manistee, Michigan.

"In addition to the above-mentioned plants, our foreign manufacturing activities are quite extensive. Handkerchiefs are made in our plant at Swatow, China, and at Porto Rico; nightwear and lingerie are manufactured by us in Manila, and gloves are made in several European countries.

"Moving toward the new objectives, it is interesting to note the following:

"(1) Sales, Merchandise and Production executives have reviewed the entire merchandising activities of the Manufacturing Division, and a close study has been made of style, quality and price of its various products.

"(2) A Bureau of Styling and Design is now actively engaged in effecting style improvements in the lines.

"(3) We are aggressively establishing a sales-promotion department, which is now practically complete.

"(4) A market research director has been engaged, whose entire time will be spent in studying logical distribution methods for our Manufacturing Division to follow.

"(5) Pricing policies have been agreed upon which will insure the sale of the products on a competitive basis, emphasis being placed upon the fact that the retailer must be permitted a proper markup.

"(6) Production equipment has been reviewed with the purpose of improving qualities and lowering costs. There is in prospect the spending of approximately $2,000,000 for the improvement of the Division's manufacturing facilities during 1936, of which between $400,000 and $500,000 has already been appropriated.

"(7) Sales offices have been set up in the various important New York buying center locations.

"In embarking upon the program outlined, Marshall Field & Company sacrifices none of its traditional policies, and the Manufacturing Division takes its rightful place in the field of modern merchandising."

6. CARLETON COMPANY

ADJUSTMENT TO PRICE CEILING

In May, 1942, the executives of the Carleton Company, a specialty wholesaler of women's sports shoes, were seeking to adjust their business to the newly established price-ceiling regulations of the OPA. They were apprehensive that these price controls in conjunction with conditions in the existing sellers' market might make it difficult for the company to maintain operations in the future.

The Carleton Company originally had been founded in Boston in 1889 as a men's retail shoe store and had continued exclusively in that end of the business until 1921. At that time the management of the retail store had started a separate wholesale business to handle men's shoes. Two years later, the wholesale business had been expanded to include women's shoes; and for the next five years the company had operated as a full-function wholesaler of a general line of men's and women's shoes. There was a demand, at this time, on the part of many retailers for shoes to be carried in stock for immediate delivery; and since not all manufacturers maintained "in-stock" departments, there was a need for the independent performance of the wholesale functions.

During the 1920's, however, various trends were developing in the shoe business which seemingly were unfavorable to the continued success of typical wholesale enterprises in that field. Among these trends were the following:

1. The rapid growth of retail shoe chains
2. The continued expansion of in-stock departments by shoe manufacturers

3. The inauguration and widespread acceptance by the retail trade of shoe shows sponsored by the manufacturers
4. The reluctance of department store shoe buyers to do business with jobbers or wholesalers
5. The widespread use of selective distribution by shoe manufacturers
6. The increased advertising of manufacturers' brands

In 1928 the management of the Carleton Company decided that, if the company was to continue in the wholesale business, its best chance for success would be in women's shoes and not men's. Furthermore, the officers thought that a company which specialized in a particular type of shoe would be in a far better position to survive than a company which carried a general line of men's and women's shoes. As a result of this decision, the company proceeded to discontinue its general lines of men's and women's shoes and to replace them with a line of women's sports shoes. Gradually this line was expanded until it became one of the most complete low-medium price lines in the women's sports shoe field.

By 1930 the Carleton Company was considered one of the outstanding wholesalers of its type in the shoe trade, and its business was reasonably profitable. In 1932, however, the sales of the company fell off badly; and the management, not satisfied that the depression was the only cause for the decline, decided to investigate. The study showed that the drop in sales volume could be attributed both to the desire of department store buyers to deal directly with manufacturers, in an endeavor to make a better profit showing, and to the fact that the depression was gradually drying up the Carleton Company's sources of supply, leaving the company without an adequate stock selection on which to do business.

The management sought to correct this situation by securing new suppliers and undertaking greater merchandising responsibilities. It entered into agreements with five manufacturers who had idle capacity and desired additional volume. These manufacturers sold their entire output to one or two large chain accounts and hence did not maintain their own salesforces. (For an indication of the marketing expenses of manufacturers who did maintain their own sales organizations to sell to retailers, see Exhibit 1.) The terms of the agreement in each instance were that the Carleton Company would furnish the raw materials, provide the lasts and dies, and perform the styling function, and that the manufacturers, in turn, would refrain from selling similar styles to the accounts of the

Carleton Company. This arrangement benefited both the contracting parties: The manufacturers were eager to receive the additional volume because it helped them to maintain a steady production rate and hold their manufacturing organizations together during the depressed times, and the Carleton Company was enabled to overcome some of the objections of department store buyers to dealing with middlemen.

The shoes carried by the Carleton Company ordinarily retailed at prices ranging from $3 to $7.50. The highest price line bore

EXHIBIT 1

MARKETING COSTS FOR SEVEN MANUFACTURERS OF SHOES IN THE UNITED STATES, 1931

(Net Sales = 100%)

Direct Selling:		
Salaries	4.54%	
Traveling	1.23	
Office	2.92	
Other	0.03	
Total		8.72%
Advertising and Sales Promotion:		
Advertising	2.64%	
Administrative	0.32	
Samples	0.71	
Total		3.67
Transportation		1.33
Warehousing		0.85
Credit:		
Collections	0.52%	
Bad Debts	1.31	
Total		1.83
Financial		2.34
General Administrative		1.69
All Other		0.76
Total Expense		21.19%

Source: Malcolm P. McNair, Stanley F. Teele, and Frances G. Mulhearn, *Distribution Costs: An International Digest* (Boston, Harvard Graduate School of Business Administration, 1941), p. 607.

the brand name Lynnfield, while the other price lines, proceeding from the high to the low, had the following brand names: Brownie, Belmont, Oakley, Tuxton, and Duchess. These were all private brands.

The Carleton Company sold to 5,000 retailers throughout the country, with major emphasis on the department store trade. Although only 10% of the company's retail accounts were department stores, these accounts were responsible for 60% of the total sales volume; in fact, a few large department store accounts contributed a substantial portion of the total for this type of outlet.

EXHIBIT 2

CARLETON COMPANY

Operating Statistics for 1937–1941

	1937		1938		1939		1940		1941	
Sales	$700,000	100.00%	$800,000	100.00%	$950,000	100.00%	$1,200,000	100.00%	$1,700,000	100.00%
Cost of Sales	590,000	84.29	665,000	83.13	800,000	84.21	993,000	82.75	1,404,200	82.60
Gross Margin	110,000	15.71	135,000	16.87	150,000	15.79	207,000	17.25	295,800	17.40
Expenses	108,200	15.44	128,000	16.00	144,500	15.21	197,000	16.42	280,800	16.52
Net Profit	1,800	0.27	7,000	0.87	5,500	0.58	10,000	0.83	15,000	0.88
Working Capital	$75,000		$83,000		$88,000		$108,000		$148,000	
Average Inventory	75,000		76,000		95,000		110,000		150,000	
% of Accounts Receivable Collected within 30 Days	50%		53%		58%		63%		68%	

The sales organization of the company consisted of 11 full-time salesmen, working on a drawing-account-and-commission basis of remuneration; the commission rate was 5%.

The shoe styles designed by the Carleton Company proved very popular with the trade, and during the period from 1934 to 1941 the company became a leader in the styling of women's sports shoes in the medium price range. Furthermore, the agreements made in 1932 enabled the Carleton Company to exert some influence on the costs of the manufacturers, who were grateful for the additional volume. Both these factors helped the company to maintain its position in the shoe field up to the end of 1941 (see Exhibit 2).

Even before that time, however, disconcerting trends again had begun to develop. In the spring of 1941, because of an increase in costs, the five manufacturers with whom the Carleton Company had entered into agreements in 1932 were forced to increase their selling prices (see Exhibit 3). The Carleton Company passed part of the increase along to the retailers in the form of higher prices; and then,

EXHIBIT 3
CARLETON COMPANY
Typical Selling Prices of Manufacturer, Wholesalers, and Retailers between Spring, 1941, and Spring, 1942

	Spring, 1941	Early Fall, 1941	Late Fall, 1941	Spring, 1942
Manufacturer's Selling Price	$1.75	$1.85	$1.90	$2.00
Wholesalers' Selling Price*	2.40	2.40	2.45	2.50
Retailers' Selling Price	3.95	3.95	3.95	3.95

* Cash discounts ranged from 2% to 8%, depending on type of retail account.

to avoid a reduction in its own gross margin, the management, before the fall line for 1941 was released, instructed each salesman to push the high-margin items in the line. This action enabled the company to maintain its gross margin position during 1941. The executives realized, however, that such a course of action was only a temporary solution.

In March, 1942, when the Carleton Company was booking orders for fall business, one of its principal suppliers, who manufactured its best-selling line of women's sports shoes, in consequence of a 10% wage advance raised the price to the Carleton Company from $2.00 to $2.20. As a result, the Carleton Company priced

this shoe to its principal retail accounts at $2.85, less a 5% cash discount. The expectation was that for fall business the retail price of this shoe would be advanced from $3.95 to $4.45.

At this juncture, however, the OPA on April 28 placed a general ceiling on manufacturers', wholesalers', and retailers' prices as of March, 1942.[1] Early in May, executives of the Carleton Company attending a shoe style show in New York City talked to many of their principal retail customers. These concerns insisted that, since they were held to a $3.95 retail price on this particular line of shoes, they would not place any further orders with the Carleton Company for fall business unless the latter "rolled back" its wholesale price to at least $2.60. Then, on consulting the manufacturer of these shoes, the Carleton Company found that because of wage advances he was very reluctant to accept any "roll back" of his price. Also, on conferring with some of its other suppliers the Carleton Company learned that, because of dissatisfaction with the narrowness of the margin between their costs and the prices which they were receiving, they were beginning to contemplate the possibility of selling direct to some of the Carleton Company's principal accounts.

What action should the Carleton Company have taken?

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[1] See the case of the National Retail Dry Goods Association, p. 553.

XIII

DIAGNOSIS OF MARKETING POLICIES

1. CABOT CHOCOLATE COMPANY

MARKETING PROGRAM

The Cabot Chocolate Company was organized in 1932 for the manufacture and sale of packaged cooking chocolate for household use. Detailed plans for the project were prepared by Mr. Cabot, the founder of the company, and submitted to banks in an attempt to enlist financial aid. The bankers were skeptical of the soundness of the project, and Mr. Cabot undertook personally to raise the needed capital from private investors. In this he was successful. The new company started production in 1933 in a New England plant purchased at a low price, using equipment in part obtained from a defunct candy company and in part specially designed and constructed for the Cabot Chocolate Company's particular purposes. Mr. Cabot became president of the new company. He expected to sell his product exclusively to large chain store companies at a price sufficiently low to take that market away from the well-known Lane cooking chocolate. In spite of the high quality of its product and a substantial price differential made possible by economies in production and distribution, the new company was unable to realize its major objective. Failure to capture the chain store market induced the management to change objectives and to seek private-brand business from wholesalers, voluntary chains, and large retailers.

According to Mr. Cabot, the following conditions existed in the cooking chocolate trade. Annual sales of unsweetened cooking chocolate for household use in the United States were approximately 15,000,000 pounds. Of this quantity, the Lane Chocolate Company consistently sold around 12,000,000 pounds, or 80%, despite the attempts of competitors to gain a larger part of the market. The remaining 20% was divided among the Archer Chocolate Corporation and a number of smaller companies. Of total sales of chocolate and cocoa combined, however, the Archer Chocolate Corporation

accounted for 54%; the Lane Chocolate Company, 22%; and the remaining companies, 24%. The Lane Chocolate Company had achieved its supremacy in the market for household cooking chocolate principally because its product did not change in flavor or appearance when boiled. This characteristic was the result of a combination of several factors. The combination was difficult to achieve and was not revealed by any analysis of the finished product. Competitors, unable to work out the proper combination, had never become large factors in the household market for cooking chocolate, although they did not have this difficulty in selling to industrial users, such as confectionery manufacturers, because the latter melted chocolate without boiling it. Likewise, no such difficulty was experienced in making sweetened chocolate or cocoa.

Mr. Cabot, who had been an executive in the Lane Chocolate Company, had been engaged for many years in the manufacture and sale of cooking chocolate. He knew the combination of factors which had made that company's cooking chocolate superior to competing products. When he resigned from his position with that company in May, 1932, he decided to form a company which would really compete with his former employer. This decision was based not entirely on his knowledge of the proper combination of production factors and his faith in his ability to put them into practice but also on his belief that he could secure several competitive advantages. Important among the advantages which he anticipated were an improved product, better dealer relations, and a lower price.

Mr. Cabot knew of many improvements in production processes and in equipment. He believed that the use of these new processes and new types of equipment would enable him to make a product of a higher and more uniform quality than that produced by the Lane Chocolate Company. He also planned to put eight individually wrapped 1-ounce squares in each ½-pound package instead of the customary ½-pound bar. These 1-ounce squares would be better adapted to household use in that they would be easier to withdraw from the package, would eliminate waste from cutting or breaking, would do away with inexact measurements, and would melt uniformly when heated. He decided to wrap the ½-pound packages in cellophane in order to keep the product fresher than competing brands. He believed that these factors would result in a product superior to Lane chocolate.

It was expected that a further competitive advantage would be gained in the form of improved relations with all types of food distributors, including wholesalers, retailers, and chain store companies. These distributors, Mr. Cabot said, were dissatisfied with many of the Lane Chocolate Company's policies. In the first place, this company refused to put up cooking chocolate under private brands. This company, furthermore, allowed small margins to wholesalers and retailers. The latter were forced to carry the product, despite the low margins, because of the well-established consumer demand for Lane products. A second set of objections centered around the acquisition of the Lane Chocolate Company in 1927 by a large merger of food manufacturing companies. Many wholesalers and retailers disliked mergers of this type. Voluntary chains particularly objected to the merged company's attempt to maintain prices by means of consumer advertising, and this objection was translated into a strong preference for private-brand goods. The merger, Mr. Cabot stated, also resulted in the centralization of such functions as credit, routing of shipments, and adjustments, a centralization which he believed caused delays and frequently prevented prompt and equitable treatment of customers. Mr. Cabot considered that the resulting dissatisfaction of wholesalers and retailers was of such importance that, by avoiding the causes of such dissatisfaction, he could obtain favored treatment from distributors.

The third and major advantage anticipated by Mr. Cabot was his ability to set his selling price substantially under that of the Lane Chocolate Company. He expected to realize this advantage as a result of product specialization, more efficient production equipment, low equipment costs, and lower selling and administrative expenses. He stated that these economies would more than offset his higher packaging expense.

Mr. Cabot planned to purchase cocoa beans from brokers. Purchases would be for current needs only. The New York Cocoa Exchange, Inc., provided facilities for trading in futures, but Mr. Cabot believed spot buying for actual current needs to be the policy best suited to the circumstances of a small company interested only in manufacturing profits. Mr. Cabot was of the opinion that the policy of buying for immediate needs would yield as low an average cost of materials as would the policy of competitors who purchased futures.

Carefully selected better grades of Bahia, Accra, and other beans would be bought from samples. The various beans would be mixed in processing to produce a particular blend, and blending was an important factor in obtaining the superior flavor which Mr. Cabot sought. He was experienced in blending and was convinced of his ability to obtain a quality product, in so far as blend was concerned, at a cost for raw materials no greater than that of his competitors.

Although competitors made as many as 150 varieties of cocoa bean products, including different unsweetened chocolates, sweetened chocolates, and cocoas, Mr. Cabot planned to make nothing but cooking chocolate, thereby avoiding the accumulation of by-products, cocoa powder for instance, which were difficult to sell profitably. Mr. Cabot knew of a manufacturer of several varieties of chocolate and cocoa whose 1931 net profit on his entire business was 25% lower than on the cooking chocolate division alone. Only because such a manufacturer was able to obtain a greater margin of profit from his cooking chocolate could the losses on the less profitable products be absorbed.

In addition to the advantages accruing from product specialization, Mr. Cabot anticipated other savings that would permit an even lower selling price. He had designed new equipment which would make possible significant reductions in direct labor costs. Although this advantage would be more than offset by indirect manufacturing costs when production was at a low rate, direct labor savings would yield a net advantage as soon as production was increased. Furthermore, Mr. Cabot knew where he could purchase a plant and equipment at a forced-sale price which would be in sharp contrast to the price paid by his major competitor for the Lane Chocolate Company in 1927. Obviously this advantage, like the savings in direct labor costs, would be fully realized only when the company attained a fairly large volume of business.

Selling and administrative expenses were expected to be substantially lower than those of the Lane Chocolate Company. Mr. Cabot did not intend to advertise. He believed that wholesalers and retailers would promote the sale of the product if they were given sufficiently high margins. He expected that another means of lowering selling expenses would result from confining sales efforts to large distributors desiring private brands. This concentration would reduce traveling expenses and would enable

Exhibit 1
Cabot Chocolate Company
Estimated Unit Costs per Pound of Chocolate at Two Rates of Production

Costs	Cost per Pound with Annual Production of 500,000 Pounds		Cost per Pound with Annual Production of 2,000,000 Pounds	
Materials:				
Cocoa Beans—including 25% Shrinkage—f.o.b. Boston at $4.85 ($4.50 to $5.45)	$0.0606		$0.0606	
Transportation Inward	0.0041		0.0040	
Packing Materials	0.0153		0.0153	
Total Material Cost		$0.0800		$0.0799
Direct Labor		0.0060		0.0050
Manufacturing:				
Factory Pay Roll, Indirect	$0.0221		$0.0058	
Fuel	0.0024		0.0009	
Power and Light	0.0090		0.0033	
Factory Expense	0.0028		0.0009	
Machinery Repairs	0.0007		0.0003	
Building Maintenance	0.0010		0.0003	
Insurance	0.0023		0.0007	
Water	0.0002		0.0001	
Rent of Siding	0.0007		0.0002	
Taxes, Local	0.0084		0.0021	
Mortgage Interest	0.0030		0.0007	
Total Manufacturing Expense		0 .0526		0.0153
Total Production Cost		$0.1386		$0.1002
Administrative:				
Office Pay Roll	$0.0517		$0.0129	
Office Expense	0.0024		0.0008	
Telephone and Telegraph	0.0016		0.0006	
Accounting	0.0020		0.0005	
Legal	0.0010		0.0002	
Collection	0.0000*		0.0000*	
Taxes, Miscellaneous	0.0001		0.0000*	
Total Administrative Expense		0.0588		0.0150
Selling:				
Pay Roll	$0.0388		$0.0097	
Selling Expense	0.0150		0.0050	
Automobile Expense	0.0015		0.0004	
Brokerage	0.0080		0.0080	
Advertising	0.0020		0.0010	
Samples	0.0024		0.0007	
Transportation Outward	0.0150		0.0150	
Total Selling Expense		0.0827		0.0398
Estimated Total Delivered Cost		$0.2801		$0.1550

* Insignificant amount.

the executives to do all the selling in addition to performing their other duties. The small organization would bring selling and administrative expenses still lower.

In order to make these production-cost and expense advantages sufficiently evident to serve as a basis for securing financial support, Mr. Cabot prepared the cost estimates shown in Exhibits 1 and 2. These estimates were based in part on known costs and in part on prices which Mr. Cabot expected to pay for

EXHIBIT 2

ESTIMATED COSTS PER 100 POUNDS OF CHOCOLATE FOR CABOT CHOCOLATE COMPANY AND LANE CHOCOLATE COMPANY

Costs	Cabot Chocolate Co.: Cost per 100 Pounds with Annual Production of 2,000,000 Pounds		Lane Chocolate Co.: Cost per 100 Pounds with Annual Production of 10,000,000 Pounds	
Raw Materials	$6.46		$6.46	
Production Labor	0.50		0.41	
Indirect Costs	1.53		1.66	
Total Production Cost		$ 8.49		$ 8.53
Packaging Labor } Packaging Material }	$1.53		$0.19	
			0.85	
Total Packaging Cost		1.53		1.04
Total Production and Packaging Cost		$10.02		$ 9.57
Administrative and Sales		3.98		7.90
Total Cost per 100 Pounds		$14.00		$17.47
Total Cost per ½-Pound Package, at Factory		$ 0.0700		$ 0.0874
Freight Budgeted		0.0075*		0.0100*
Total Cost per ½-Pound Package Delivered		$ 0.0775		$ 0.0974

* L.c.l. rate per ½-pound package, Chicago to Boston: $0.004 ($0.39 per 48-pound case).

equipment and plant and salaries for executives. Dollar costs were reduced to unit costs per pound and per 100 pounds to facilitate comparison with estimates of costs of the Lane Chocolate Company. The latter estimates were based on Mr. Cabot's personal experience with that company.

When annual production for the Cabot Chocolate Company increased to 3,000,000 pounds, 4,000,000 pounds, and 6,000,000 pounds, the unit cost at factory per 100 pounds would drop to estimated totals of $11.7189, $11.3049, and $10.7509, respectively. The principal savings to accrue from increased production

volume were in indirect production costs and in administrative and selling expenses. The cost estimates for all volumes included allowances for changes in raw material prices, shrinkage, losses from heat spoilage, and other contingencies. For instance, the raw material figure was set 2 cents a pound above the then prevailing price to give a margin of safety of over 30% of the figure used for budgeting purposes. These cost estimates were believed to represent maximum rather than minimum figures.

The initial plans for the formation of the Cabot Chocolate Company were completed by the summer of 1932; all further action was dependent on the raising of capital. Mr. Cabot estimated that $300,000 would provide for fixed investment, working capital, and operating losses which might be incurred during the first few months of operation. Again, Mr. Cabot took a conservative attitude and worked on the assumption that no income would be received during the first six months of operation. Mr. Cabot then presented his plans, cost figures, and capital estimates to bankers in an attempt to obtain financial support. The latter were skeptical of the soundness of the plan and refused to provide the necessary money. Mr. Cabot, therefore, decided to raise the required funds from private investors.

The Cabot Chocolate Company was incorporated with an authorized capital of 3,000 shares of $100 par value preferred stock and 1,200 shares of no-par common stock. The preferred stock carried a 10% dividend rate, of which 6% was cumulative and 4% noncumulative. The 4%, or any part of it, was payable concurrently with equal dollar payments to the common stockholders. The preferred stockholders were given 1 share of common stock for every 10 shares of preferred that they purchased. Six hundred shares of common stock were issued to the executives; 190 shares were received by Mr. Cabot, the president, and each of the other officers received an equal part of the remainder. Three hundred shares of common stock were not issued but were held in reserve for future financing. Before the end of the year Mr. Cabot sold $242,000 worth of preferred stock. He was forced then to subordinate capital solicitation to starting the company in operation, but he planned to sell the remaining $58,000 of preferred stock in the spring of 1933.

Mr. Cabot spent much of his time during the last half of 1932 in securing his plant and equipment. He purchased all but the

highly specialized equipment from a candy manufacturer who was liquidating his business. This used equipment was in excellent condition and was of such a type that actual depreciation and obsolescence rates and costs would be low. The special equipment was made to order. Though complicated, this equipment was not difficult or costly to operate and maintain. Mr. Cabot found a suitable plant, which he purchased for one-third of its assessed valuation, inducing the former owner to take a 10-year serial first mortgage. The plant was modern, suitable for chocolate

EXHIBIT 3
CABOT CHOCOLATE COMPANY
Balance Sheet as of December 31, 1932*

Assets	
Cash in Banks and on Hand	$ 29,472.92
Preferred Subscriptions (due Jan. 3, 1933)	60,900.00
Accounts Receivable	194.94
Real Estate	49,592.42
Machinery and Equipment, Furniture and Fixtures	138,424.62†
Merchandise: Beans, Packing Material, and Chocolate in Process (at cost)	8,870.40
Prepaid Insurance, Taxes	1,538.14
Preferred Subscriptions (past due)	1,500.00
Organization Expense (to Aug. 1, 1932)	6,077.99
Deficit	25,804.02
Total Assets	$322,375.45
Liabilities	
Accounts Payable	$ 23,220.73
Contracts Payable (machinery)	16,390.34†
Real Estate Mortgage (serial to 1942)	32,885.65
Preferred Stock Subscribed	62,500.00
Preferred Stock Issued ($100 par)	187,300.00
Common Stock (no par 787.3 shares issued at nominal value of 10 cents a share)	78.73
Total Liabilities	$322,375.45

* At start of manufacturing.
† Includes items contracted for but not received.

production, located on a railroad siding, and near a good source of labor of the type needed. These purchases not only made it possible to start production by January 1, 1933; but also substantiated the cost estimates which had been made at an earlier date. The company's balance sheet after the purchase of the plant and equipment was as shown in Exhibit 3.

Mr. Cabot chose as executive personnel several experienced businessmen who had been associated with him in the chocolate business. The officers of the new company agreed to accept one-half their former salaries and to take the remainder of their com-

pensation in the form of dividends on the common stock, when and if earned. Most of the men in the organization could act in various capacities; hence the company would be amply protected in the event of sickness or death.

Inasmuch as the production of samples was scheduled for January 1, 1933, it was necessary to establish a selling price for the new product. The ½-pound package of Lane chocolate was selling to wholesalers and chain store companies for 17.8 cents ($4.30 for a 12-pound case). Archer cooking chocolate sold to the same market for 10 cents for a ½-pound package. Since Mr. Cabot wished to sell in the price class of the Archer Chocolate Corporation, he arbitrarily selected a price of 11 cents. He later decided that he could obtain 12 cents just as easily because that was still almost 6 cents under the price for Lane chocolate. Having concluded that 12 cents was a desirable price from the demand standpoint, he compared this with the 7.75-cent delivered cost figure and the company's financial requirements. Even though the manufacturer's gross margin at the 12-cent price was 35% as compared with 45% for the Lane Chocolate Company, Mr. Cabot estimated that the company would break even when it was operating at the rate of 750,000 pounds a year and would earn a preferred dividend at a 1,000,000-pound rate. In view of the possibilities of selling several million pounds of chocolate a year, Mr. Cabot decided that the price of 12 cents was satisfactory from the standpoints of both demand and cost.

Mr. Cabot recognized that the finances of his company would not permit large expenditures for selling the cooking chocolate. For that reason, he decided to concentrate sales efforts upon large grocery chain store companies. He expected that it would be necessary to establish contacts with only a few central purchasing offices of those systems to obtain distribution for the product in hundreds of retail stores.

The plan of selling Cabot-brand chocolate to large chain store companies at 12 cents was expected to be effective because these chains would have a gross margin of approximately 37% if they sold the product to consumers for 19 cents, or 2 cents under the then average retail price for Lane chocolate. All the large chains approached by Mr. Cabot, however, failed to respond to the high-margin incentive. They stated that their business was primarily selling rather than merchandising and that they could not diverge

from this policy on a product such as cooking chocolate which had relatively small sales for each retail store. They assured him, however, that when he had established a consumer demand for his product they would be interested in it.

As a result of this experience a revised plan was drawn up for selling chocolate under private labels to wholesalers, voluntary chains, and large retailers. This plan likewise depended on high distributor gross margins for its success. The company agreed to make private-brand chocolate for any customer who signified a willingness to order 250 of the 48-pound cases within a reasonable period of time. It did not require a customer to order the 250 cases at one time. The 250-case requirement merely served as a basis on

EXHIBIT 4
PRICE SCHEDULES OF CABOT CHOCOLATE COMPANY AND LANE CHOCOLATE COMPANY

Item	Price per 6-pound Box	
	Cabot Chocolate Company	Lane Chocolate Company
Price to Wholesalers	$1.44	$2.15
Wholesalers' Price to Retailers	1.80	2.25
Retailers' Price to Consumers	2.28*	2.52†
Wholesalers' Margin	20%	4.4%
Retailers' Margin	21%	10.7%

* Based on retail price per package of $0.19.
† Based on retail price per package of $0.21.

which the company could print private-label cartons in advance of orders. Any customer who failed to accept 250 cases of chocolate was required to buy at cost the cartons printed with his labels, the maximum liability of the customer not to exceed $200. These provisions did not influence a customer to overstock; yet they completely protected the company, as its only expense in making private brands was the printing of cartons. The price schedule established for private-brand customers as well as for those selling the Cabot brand was as shown in Exhibit 4, in comparison with the Lane Chocolate Company's prices for its own brands.

Although the price schedule shown in Exhibit 4 applied both to the Cabot-brand chocolate and to private brands, the company could exert more influence on maintaining the $1.80 and $2.28

prices with its own brand than it could with private brands. Mr. Cabot desired, as a long-run policy, to restrict his business primarily to the Cabot brand; but he did not believe that he could develop the market for his own brand fast enough to maintain a sound financial position. For this reason, he decided to concentrate temporarily on private-brand business and to dispose of as much Cabot-brand chocolate during that time as could be sold without much effort.

For the market comprised of hotels, restaurants, and institutions, Mr. Cabot intended to sell the 1-ounce squares, unwrapped, in 10-pound cases. These cases were to be unmarked except for the customer's name and address, which would be stenciled on the cases just before shipment. No trade discounts were established for this market. Any customer could buy less than 100 pounds for 19 cents a pound or 100 pounds or more for 15 cents a pound. This quantity price differential would enable wholesalers to sell to the smaller restaurants, hotels, and institutions which were unable to purchase 100 pounds at one time. The 15-cent and 19-cent prices were based on the average prices charged by competitors selling to this same market. Mr. Cabot considered it unnecessary to underprice competitors in this market; he was willing to rely on the improved quality of his product and the greater convenience of the 1-ounce squares. As in the case of the private-brand business, the same finished product could be used because the manufacturer's name would not be imprinted on the chocolate.

The company selected as its initial market an area extending north to Portland, Maine; west to Chicago, Illinois; south to Knoxville, Tennessee; and east to the seacoast. One of the officers took the territory between Chicago and New York City; a second, the territory including the coastal cities between New York and Norfolk and inland in Ohio and Pennsylvania; the third, New York City and New England. Brokerage connections were established in Norfolk, Nashville, Knoxville, Richmond, and Chicago. The brokers, working on a 5% commission under contracts terminable at any time by either party, gave the company added market contacts during the period when the officers were doing the initial promotion work.

The company started production during the first few days of January, 1933. At first the entire output was used for samples. Each officer carried a small sample case containing chocolate

packaged under the company's own label and under the private labels of two wholesalers who had already given orders to the company. In addition to the sample cases, the officers had pictures of the exterior and interior of the plant. These pictures were

EXHIBIT 5
CLASSIFICATION OF RETAIL FOOD STORES IN UNITED STATES, 1929

Kind of Business	Number of Stores	Number of Chains	Number of Units in Chains
Total Food Group	481,891	1,461	61,416
Candy and Confectionery Stores:			
Candy Stores—Nut Stores	2,658	123	1,461
Confectionery Stores (candy and fountain)	60,607		
Dairy Products Stores:			
Dairy Products Stores including Ice Cream	4,488	85	1,201
Egg and Poultry Dealers	3,258		
Milk Dealers	3,990		
Delicatessen Stores	11,166		
Fruit Stores and Vegetable Markets	22,904	51	383
Grocery Stores (without meats)	191,876	313	12,330
Combination Stores (groceries and meats):			
Grocery Stores with Meats	91,888	475	41,136
Meat Markets with Groceries	23,661		
Meat Markets (including sea foods):			
Fish Markets—Sea Foods	6,077	12	51
Meat Markets	43,788	234	2,753
Bakeries—Caterers:			
Bakeries—Bakery Goods Stores (except manufacturing bakeries)	11,903	110	1,216
Caterers	110		
Other Food Stores:			
Coffee, Tea, Spice Dealers	1,236	58	885
Farm-Products Stores	974		
General Food Stores (miscellaneous)	686		
Bottled Waters and Beverage Dealers	621		

Source: U.S. Bureau of the Census, *Census of Distribution: 1929, Retail Distribution* (Washington, Government Printing Office, 1930), Vol. I, pp. 30 and 47.

intended to convey the impression of stability, cleanliness, and efficiency.

Food stores constituted the market for cooking chocolate. The classification of such stores according to the U.S. Census of Retail Distribution for 1929 was as shown in Exhibit 5. Potential customers who were called on included small chain store companies, wholesale grocers, large retailers who normally bought direct from manufacturers, and small retailers. Sales to small retailers were made at the $1.80 price for a 6-pound box in order to protect whole-

salers, but orders so secured were not turned over to wholesalers until satisfactory wholesale connections had been established. In selecting potential customers during this initial promotion period the company's officials were guided by several considerations. Their primary objective was to seek out wholesalers and voluntary chains known to be active in the development of their own private brands. The officers agreed to offer Cabot-brand chocolate to these customers whenever they showed a lack of interest in private-brand chocolate. For the sale of Cabot-brand chocolate, the officers attempted to select a few important wholesalers and retailers in each territory. All attempts to sell Cabot-brand chocolate to small retailers and unbranded chocolate to restaurants and institutions were more or less experimental and incidental to the other work. The promotional work done by the officers was not supplemented by other forms of promotion such as trade and consumer advertising. Mr. Cabot believed that he and his fellow officers could make sales through personal interviews, whereas impersonal methods would be ineffective because of the previous failure of any competitors of the Lane Chocolate Company to bring out a satisfactory cooking chocolate.

The Cabot Chocolate Company intended to use all legal measures available to maintain the $1.80 price to retailers for Cabot-brand chocolate, so as to prevent the product from becoming a price football. Although no attempt was made to maintain the $1.80 price on private-brand chocolate, it was expected that the owners of the private brands would tend to follow the prices set for the Cabot brand. A rigid one-price policy was adopted; and the company, unlike its competitors, made this policy effective by refusing to give quantity discounts, free deals, or advertising allowances. Credit terms were 2%, 10 days, net, 30 days. The company, following the practice of its competitors, paid freight charges on all orders of two cases or more. Package units were as follows:

8	1-oz. Squares	=	1	½-lb. Carton
12	½-lb. Cartons	=	1	6-lb. Box
8	6-lb. Boxes	=	1	48-lb. Shipping Case

All returns because of heat damage, which was a serious problem during the summer, were accepted for full credit. Although marked changes in the price of cocoa beans would eventually require changing the price of the finished product, the company proposed

to hold the price of its product stationary for as long periods as possible.

Mr. Cabot did not anticipate any difficulties in his competition with Lane chocolate so long as he confined the activities of his company primarily to private-brand business. This he intended to do until he had a substantial volume of business and adequate finances. He proposed to shift his policies at that time and aggressively to develop the sales of the Cabot brand. He expected that this course of action might cause the Lane Chocolate Company to retaliate with a price reduction. Mr. Cabot stated that he would meet such a reduction by raising the price of his own product, on the theory that there was a definite correlation, in the minds of consumers, between high price and high quality.

Mr. Cabot also believed that he would be able, at some time in the future, to reach an agreement with some manufacturer of a noncompeting food product whereby both companies could utilize the same salesforce and other marketing facilities.

2. SLIDE-O-SCOPE

MARKETING PROGRAM

In January, 1939, Mr. Carter and Mr. Chase wished to attack the problem of working out a comprehensive marketing program for the Slide-O-Scope, a new type of electric slide viewer which they had invented.

For several years the two men had made a hobby of photography and had spent many evenings together viewing their pictures with the aid of a projector. But they had never been able to find a thoroughly satisfactory machine; the device which they had been using, although one of the most expensive on the market, failed to give their pictures a lifelike appearance. Since both men enjoyed working with photographic equipment, they decided, in the fall of 1937, to experiment with a slide viewer of their own. Each had had valuable experience, for Mr. Carter was employed by a lens manufacturer and Mr. Chase was a lighting consultant for a utility company.

In the course of several weeks, Mr. Carter and Mr. Chase developed a new slide viewer made from a cigar box, which housed

a lens, socket, cord, plug, diffusing glass, and bulb. In the top of the box was a narrow opening for inserting the slides. Although the device was crude in appearance, it proved to be far more effective in performance than the machine which the men had been using. It brought pictures to life with astonishing detail and brilliance and gave them an illusion of third dimension. The inventors were much pleased with the results of their experiments and anticipated many pleasant hours with the new slide viewer. They did not at first consider the possibility of commercializing their invention, but everyone who saw the equipment was most enthusiastic and urged that it be put on the market. Friends argued that production and distribution costs would be so low that there would be an opportunity for a substantial profit on the new device. These arguments finally convinced Mr. Carter and Mr. Chase that they should market the product.

In the spring of 1938, the inventors secured the services of an industrial designer to design the slide viewer and make the blueprints necessary for its production. The next step was to obtain a manufacturer to turn out the device. After some difficulty they found a concern which would undertake the job, provided the molds were furnished by the inventors. The costs which the manufacturer quoted for lots of 1,000 were as follows:

Cases	$ 730*
Lenses	500
Sockets	41
Cords and Plugs	85
Diffusing Glasses	35
Bulbs	75
Rims	42
Screws	10
Assembling	200
	$1,718
Packages	36
Circulars	50
Total	$1,804

* The cost of the cases was figured on a basis of production with single molds. The inventors had purchased a single mold for the upper case and another for the base at a cost of $1,000. Production on a multi-unit-mold basis would reduce the cost of the cases 66⅔ %. The cost of the multi-unit molds would amount to between $3,000 and $4,000.

The manager of the manufacturing concern also insisted on a down payment of 50% of the production costs as insurance that the two men would not withdraw from their new venture. This payment of $900 added to the cost of the molds and the designer's

fee called for an initial investment of $2,000, which the men took from their savings. But in order to have the necessary funds to pay for the remainder of the first lot when it was produced, as well as to meet the patent and trade-mark costs and sales promotional expenses, the inventors were forced to secure personal bank loans of $1,000 each.

At first the manufacturer encountered some difficulty in production; but the slight changes eventually required in the design and molds had little effect on the appearance of the finished product. The component parts of the Slide-O-Scope were a black case of durable bakelite, a 2-inch high-quality optical lens which magnified two diameters, a standard 7-watt Mazda lamp, an approved electric cord and socket, and a diffusing glass. Upon receipt of the first slide viewer, Mr. Carter and Mr. Chase filed an application with the U.S. Patent Office; and at the insistence of friends they decided to give the product a trade name. After considerable thought and research, they chose the name "Slide-O-Scope" and prepared to register it as a trade-mark in the United States and Canada.

With arrangements completed for the protection of the Slide-O-Scope, Mr. Carter and Mr. Chase turned their attention to a marketing program. They were convinced that their product was far superior to any electric slide viewer on the market for 35 mm. and Bantam Kodachrome film. Its compact size (5¾ by 3 by 2½ inches) made it convenient to use; focusing and squinting were eliminated; and true color and brilliancy were assured both day and night.

In view of these advantages and their desire to amortize the cost of the molds over the first lot of 1,000, the inventors priced the Slide-O-Scope at $5. The market for slide viewers at that time was dominated by three devices. Two of these depended on a good external light and careful focusing for best results; under these conditions they provided a definite illusion of third dimension. The third type was a pocket-size slide viewer with a battery, which merely illuminated the slide without giving an appearance of depth. The first two were priced at $3.95, and the third at $1.65.

The inventors were convinced that there was a large potential market for their product.[1] The Slide-O-Scope could be used in

[1] A leading manufacturer of photographic equipment estimated that there were 19,000,000 cameras in the United States; that 500,000 of these were equipped for color film; and that a total of 600,000,000 pictures were taken annually, of which 37,500,000 were color pictures.

homes, offices, hospitals, and dental offices, as well as by salesmen. Nevertheless, the selection of suitable channels of distribution for reaching this market was perplexing. Study revealed that cameras and photographic supplies were offered for sale by automobile accessory, department, drug, electric appliance, hardware, jewelry, sporting goods, and stationery stores, as well as by photographic supply stores. Among these types of outlets there was a wide variation in the typical percentages of total expense.[1] There were variations also in size and in methods of purchasing. Some of the larger concerns bought direct from manufacturers, but most of the small concerns were forced to rely on wholesalers for their supplies. Hence to secure complete coverage of the market Mr. Carter and Mr. Chase might need to employ various types of wholesalers, as follows: automobile accessory, drug, electric appliance, hardware, jewelry, photographic supply, sporting goods, and stationery.

After reviewing possible channels of distribution and considering the gross margins which seemed to be customary, the inventors concluded that for the time being they would have to rely largely on direct distribution of their product to users. In May, 1938, the C & C Specialty Company was formed; and the owners, with the aid of their friends, engaged in a program of advertising, publicity, and sales effort. But sales throughout the summer and fall were disappointing (see Exhibit 1), and the inventors gave further thought to the problem. In December of 1938, they decided to determine dealer and consumer reaction by inducing certain retail outlets in the Boston area to carry the Slide-O-Scope. Five camera shops and one department store agreed to place initial orders of one-half dozen and to use any point-of-sale advertising that the C & C Specialty Company might furnish. On December 12, deliveries were made to the stores at the retail price of $5 less 40%. Each order was accompanied by a counter-display stand, which cost 75 cents, and a supply of circulars describing the product and its uses. One week later, the inventors received a report from a professional shopping bureau stating that only two of the stores were featuring the display stand and that the Slide-O-Scope was

[1] For data on typical operating costs both of retailers and of wholesalers see Malcolm P. McNair, Stanley F. Teele, and Frances G. Mulhearn, *Distribution Costs: An International Digest* (Boston, Harvard Graduate School of Business Administration, 1941). See also U.S. Bureau of the Census, *Census of Business: 1935, Retail Distribution*, Vol. I, and *Wholesale Distribution*, Vol. I (Washington, Government Printing Office, 1937).

the last product to be shown when customers asked to look at slide viewers. In spite of this lack of cooperation on the part of the stores, 100 Slide-O-Scopes were sold in the first two weeks—almost as many as had been sold in six months by the direct marketing method.

In reviewing their experience, however, Mr. Carter and Mr. Chase concluded that all their marketing efforts up to date were not developing enough sales volume to make their venture worth the time and energy expended. Consequently they sought to formulate a more comprehensive program.

EXHIBIT 1

SLIDE-O-SCOPE

Results of Advertising, Publicity, and Sales Effort, June–December, 1938

Date	Publication	Size of Advertisement	Cost	Unit Sales
	Paid Advertising			
June 15	*Popular Photography*	3″ × 6″	$112	23
June 30	*Horticulture*	2″ × 4″	6	3
July 15	*Horticulture*	2″ × 4″	6	2
July 30	*American School of Photo News*	3″ × 5″	12	2
	Free Publicity			
June	*Camera-Craft*	3″ × 5″	....	3
June	*The Professional Photographer*	3″ × 3″	....	1
July	*The Commercial Photographer*	3″ × 5″	....	3
July	*American Photography*	1″ × 3″		
July	*Photo Technique*	4″ × 6″	....	3
	Sales Effort			
June–Dec.	Direct effort of owners and friends	....	....	75
Total			$136	115

3. BLUEGRAY COMPANY

MARKETING PROGRAM

Early in 1940, Mr. Johnson, the president of the Bluegray Company, undertook to reappraise the company's distribution policies. This move was prompted by the granting of an associate-store contract to the Pever Hardware Company on terms somewhat different from those granted to the other Bluegray associate stores.

The Bluegray Company, located in a midwestern industrial city, had been founded in 1910 to manufacture and sell paint to several near-by toy manufacturers. The company had continued to specialize in industrial paints until 1927. In that year Mr. Johnson, previously employed as production manager and assistant sales manager of the Souman Company, a medium-size successful firm in the same area, bought the Bluegray Company from the founder for a cash down payment and a series of notes to be met out of the company profits. Mr. Johnson was then only twenty-nine years old. At this time the Bluegray Company's sales of paints and varnishes to industrial concerns amounted to about $150,000. From his previous experience, Mr. Johnson knew that industrial sales were likely to fluctuate widely from year to year; his first move, therefore, was to start building a line of "package goods" (standard grades of paint put up under a brand name) to be sold through dealers to painters and homeowners.

In order to sell the package goods it was necessary to establish retail connections, since the company had previously relied on salesmen's direct contacts with industrial concerns. The Souman Company had had a well-developed dealer organization in the metropolitan area in which the Bluegray Company was located; hence Mr. Johnson had a great many friends among hardware dealers who sold paint. With the help of several other men who had come from the Souman Company to work for him, Mr. Johnson established a number of outlets among these hardware dealers. The chief limitation from which the company suffered in building a dealer organization was lack of capital with which to extend credit to dealers to enable them to carry stock. In order to sell paint to hardware stores it commonly was necessary to extend three to four months' credit; hence the company needed $1,000 to $5,000 capital for each dealership established. Within two years, nevertheless, 43 dealerships had been established in hardware stores. In addition two company-owned stores had been opened, one in 1928 to serve as a point from which to observe developments in the retail paint business, and the other in 1929 to secure retail distribution in an area where the company had been unable to make a dealer connection.

In 1930 one of the Bluegray chemists was found to be working on paint formulas in the company laboratories and turning them over to one of his relatives in a small rival paint company. When

this chemist was discharged, he immediately joined the rival company and began to draw dealers away from the Bluegray Company by assuring them that he sold the same paint at a lower price. In order to meet this competition Mr. Johnson hired an experienced paint salesman for the purpose of establishing new dealerships. This salesman believed that lumberyards would prove to be more satisfactory credit risks than hardware stores, and within a short time he had concentrated the Bluegray dealer organization almost entirely around them. Thus by 1935 the company had 90 lumberyards as dealers and only 1 hardware store (see Exhibit 1).[1]

EXHIBIT 1
BLUEGRAY COMPANY
Retail Outlets in 1929, 1935, and 1940

Year	Dealers		Company Stores
	Hardware Stores	Lumberyards	
1929	43*	..	2
1935	1	90	12
1940	2	92	13

* Of these stores, 18 were full-line dealers and 25 carried only part of the line.

The establishment of lumberyards as dealers was followed by a loss of business from painters. The average lumberyard manager did not wish to leave his place of business in order to sell paint, and painters generally preferred to buy from salesmen who approached them, rather than go to the stores to buy. The refusal of many lumberyard managers to go out and sell paint was partially explained by the fact that a number of the yards were one-man businesses which could not be left unattended. An even more important reason, however, was that sales of paint amounted to only about 5% of total sales in the average lumberyard, as compared with a considerably higher percentage in hardware stores. Contractors, on the other hand, often came to the yards to obtain supplies and bought paint to be used by the painters whom they employed.

[1] The number of hardware stores, paint, glass, and wallpaper stores, and lumberyards in the company's trade area in 1935, as reported in the Census of Business, was as follows:

Hardware Stores	832
Paint, Glass, and Wallpaper Stores	337
Lumber and Building Material Establishments	354

When the Bluegray Company attempted to supplement lumberyard dealers with other types of dealers, it encountered difficulty. The executives realized that the slightly higher prices of the Bluegray products (see Exhibit 2) constituted a possible obstacle. Hence, in talking to hardware merchants and other potential dealers, they stressed three arguments:

1. Bluegray paint was of such high quality that a dealer could demonstrate to painters that this paint would cover a surface at a lower cost per square foot than cheaper paints.
2. The Bluegray line of 200 grades and colors was exceptionally complete and therefore obviated the necessity for dealers to carry extra shades of paint in any other manufacturer's line.
3. The Bluegray Company maintained a salesforce of three men (in addition to the three men who sold paint in the industrial market), whose only job was to work with the company's dealers and assist them in making sales. Each of these salesmen worked with a sufficiently small number of dealers so that he could call on them at intervals of no more than 10 days, a considerably greater frequency of call than was customary for most paint companies.

Despite its effort to stress these advantages of handling the Bluegray line, the company had been unable to establish many new dealerships. The executives attributed their failure to obtain dealers in part to the fact that many hardware store managers would not break away from the large paint manufacturers because of indebtedness or because of stocks which would have to be sold at a loss in the event of a change of brand. The executives also realized that many dealers were attracted to the nationally advertised brands because they believed that with so little apparent difference in paint quality the customers tended to prefer the paints with the best-known names. The Bluegray executives, on the other hand, argued that people bought paint not because the brand name was familiar but rather because it was the brand sold at the retail store which they preferred to patronize. As evidence they pointed to the substantial sales of paint under the private brands of the large mail-order stores in the vicinity.

In 1930 Mr. Johnson became convinced that in order to obtain adequate retail business the company should develop a chain of company-owned retail stores. He was fully aware that this type of expansion would require more capital than expansion through the acquisition of additional dealers, but he nevertheless considered that company stores were necessary. Particularly, Mr. Johnson

thought, they would increase the effectiveness of sales promotion. The merits of Bluegray products needed to be demonstrated to prospective users, especially since the company did not carry on an extensive advertising campaign. Demonstration kits had been provided for salesmen; and it was thought that store managers, using their stores as a base of operations, might employ similar demonstration materials in bringing Bluegray products to the attention of painters and contractors in the surrounding areas. The officials began, therefore, to establish retail stores selling only the products which the Bluegray Company manufactured or sold as a jobber. By 1934, 12 stores had been established within 75 miles of the company plant. After the store program was started,

EXHIBIT 2
BLUEGRAY COMPANY
Retail Prices of Selected Bluegray Products Compared with Those of National Brands

Products	Bluegray Prices	National-Brand Prices
Standard White House Paint	$3.25	$3.25
Varnish (first grade)	6.00	5.50
Semi-Gloss (colored)	3.75	3.50
Flat White (inside paint)	2.75	2.75
Floor and Deck Enamel	3.85	3.50

the company found that the independent merchants who were prospects for dealerships resented the establishment of stores by the manufacturer. The executives tried to point out that the company opened stores only where no dealers existed. The prospective dealers argued, however, that a company store manager, acting as an outside salesman, covered a territory extending considerably beyond the boundaries of the town in which the store was located.

In opening a store the company expected to invest an average of $3,500 in stock and $5,000 in accounts receivable, fixtures, and an allowance for the operating losses which would be incurred before the store obtained a profitable volume. By 1934 the company had reached the limit of its capital available for store expansion; therefore it stopped adding new stores and attempted to consolidate the position of the stores already established. Two stores were dis-

continued, one because a suitable manager could not be found in the city in which it was located, and another because of very high overhead. The capital freed when the two stores were closed was used to open two new stores in more suitable locations. Early in the company's experience with stores, the executives learned that the best location within a city was on the edge of the shopping district, where the rent was low. Only a small part of the sales of a typical paint store consisted of the over-the-counter transactions to retail customers; the bulk of sales took place outside the store to painters and other large buyers. While another man remained in the store as clerk, the store manager acted as salesman and performed a great many services, including delivering paint and making estimates of the quantities required for jobs on which painters

EXHIBIT 3
BLUEGRAY COMPANY
Gross Margin for Paint, Wallpaper, and Sundries in Company-Owned Stores, 1938
(Net Sales = 100%)

	Highest	Lowest
Paint	49.0%	39.0%
Wallpaper	61.0	49.0
Sundries	38.1	17.1

wished to bid. In 1938, 88.2% of the total sales of paint in Bluegray Company stores were made to painters. Apparently this experience ran counter to the reported tendency for homeowners to buy paint and hire painters to apply it.

In addition to the paints and varnishes manufactured by the Bluegray Company, the stores carried three lines of wallpaper which the company purchased from wallpaper mills. The least expensive line, which sold at prices ranging from 10 cents to 60 cents a roll, was kept in stock at all times in most of the stores. The second line, ranging from 40 cents to $1.50 a roll, was not kept in stock but simply ordered on the basis of samples whenever a customer desired it. The third line, which was also ordered on this basis, consisted of very expensive art papers, often made up on individual orders. The stores also carried a group of items classified as sundries, including putty knives, brushes, lead, and the like. Dollar sales of the stores were divided among the three general classifications of mer-

chandise as follows: 50% paint, 30% wallpaper, and 20% sundries. Gross margin figures for the three groups were as shown in Exhibit 3.

The Bluegray Company sold the paint to the stores division, which was incorporated as a separate company, on the basis of cost plus 20%. The cost figure included materials, production costs, manufacturing overhead, and a portion of the salaries of the president, the advertising manager, and several other officials, as well as all the expenses of the store supervisor and a share of the credit expense. In fact, the 20% received by the manufacturing division above the cost figure was practically net income for that division. Sundries were sold to the stores division at cost, and wallpaper at cost plus 12%.

EXHIBIT 4
BLUEGRAY COMPANY
Cost and Retail Prices for Standard White House Paint and Varnish by Types of Outlet
(Per Gallon)

	Dealers	Associate Stores	Company Stores
Standard White House Paint:			
Retail Price	$3.25	$3.25	$3.25
Painters' Price	2.85	2.85	2.85
Cost to Outlet	2.45	1.90	1.80
Cost to Company	1.50	1.50	1.50
Varnish (high grade):			
Retail Price	6.00	6.00	6.00
Painters' Price	4.50	4.50	4.50
Cost to Outlet	3.30	1.84	1.38
Cost to Company	1.15	1.15	1.15

The stores resold the merchandise in accordance with the standard printed prices issued by the company (see Exhibit 4). A separate list for painters was printed with prices somewhat lower than the retail prices, although not uniformly so. The only variation allowed from the two sets of list prices was a volume discount of 10% below the painters' price for large contractors. There were some unofficial variations from the price lists for local competitive reasons; but in general the stores held to the printed prices, and most of the independent dealers followed their lead in this matter. The publishing of a separate list of prices for painters was not common in the industry. Usually the dealer quoted a retail list price and gave the painter whatever discount was necessary to get his business.

The store managers, most of whom were experienced salesmen and store managers previously employed by the Souman Company, received weekly salaries of $25 to $40 plus a share of the store profits. It was hoped that the profit-sharing arrangement would encourage the managers to keep expenses at a minimum while trying to increase sales. There was no uniform layout or prescribed procedure which the stores were required to follow, but information on various merchandising practices which had proved valuable was passed along by the supervisor of the company stores. This executive, who was the only official contact between the stores and the manufacturing division, acted really as a sales manager to the stores division, by assisting the store managers with difficult accounts as well as running sales contests and group meetings.

In 1935 Mr. Johnson was approached by Mr. Bonds, a personal friend who had previously been a security underwriter in the firm which had helped Mr. Johnson raise the money to buy the Bluegray Company. Mr. Bonds was unemployed and asked Mr. Johnson to help him out. He knew nothing about paint but thought that he might be able to sell some in his home town, which was a small city 30 miles from the Bluegray factory. Mr. Johnson did not wish to tie up capital in another store at this time, and Mr. Bonds had no capital of his own. Mr. Johnson, however, conceived the plan of giving Mr. Bonds a discount larger than that received by regular dealers but not so large as that received by the company stores. In return, Mr. Bonds was to establish a store under the Bluegray name to handle the line exclusively. He was to receive a stock of merchandise on credit, but Mr. Johnson expected him to pay for the stock out of the earnings of the store as rapidly as possible. Mr. Bonds undertook the operation of a store on this basis; and within three years he had established a $4,000 equity in the business, meanwhile having paid himself a salary of $40 a week during the period. Upon observing Mr. Bonds' success, Mr. Johnson concluded that the associate-store plan offered possibilities for further expansion of the Bluegray business.

The Bluegray associate-store plan was based on granting the associate store prices on all products which on the average were lower than the regular dealer prices by the expense which the company ordinarily incurred to maintain contact with its dealers. This expenditure was estimated at about 20% of sales, broken down as follows:

Salesmen's Salaries	10.0%
Traveling Expense	2.0
Advertising	4.0
Freight	3.0
Credit Loss	0.5
Adjustments	1.0
Total	20.5%

The lower price was not given as a discount from the dealers' price; instead the associate stores were quoted a net price on each item. Because of competition it was often necessary to vary the markup somewhat, depending on the nature of the product. For example, a highly competitive type of house paint which sold at retail for $3.25 a gallon was sold to a dealer for $2.45 and to an associate store for $1.90; but a noncompetitive varnish which was sold at $6 a gallon at retail was sold to a dealer at $3.30 a gallon and to an associate store at $1.84 a gallon (see Exhibit 4). The prices were adjusted every three months on the basis of changes in cost. The associate stores were expected to pay cash for all stock by the tenth of the month following the date of shipment. These stores were expected to be practically self-sufficient in operation. Their only supervision was by the advertising manager of the company, who was assigned the responsibility for establishing the associate stores. Instead of learning about the product from salesmen, the proprietors of associate stores were permitted to attend the company sales meetings and to receive at first hand all the information commonly furnished the salesmen.

On a basis of cost plus 35% the company did not offer an associate store quite so great a saving on wallpaper as on Bluegray paints and varnishes, but it offered associates the privilege of returning any paper which was not selling well. All sundries were to be sold to the associate stores at cost, except brushes, which were to be sold at cost plus 15%.

In 1937, soon after the associate-store plan was formulated, it was necessary to dismiss one of the company salesmen because of a decreased volume of business. The president suggested to him that, if he could get someone to back him, he might operate an associate store. Within a short time this salesman obtained help from a large construction company which purchased a great deal of paint from the Bluegray Company, and an associate store was opened. The construction company promised to put up the capital necessary for

the initial stock, and the former salesman was to manage the store for 25% of the net profits plus a salary. The construction company was to have the privilege of buying paint for its own needs at prices equivalent to billed cost plus 10%. Soon after the store was opened, with the Bluegray Company extending credit for the initial stock, general business conditions became very poor, and the construction company was not able to advance any capital for the store. The store's volume was disappointing from the start; and because about one-third of the total sales were made to the construction company, the gross margin was very low. The manager continued to draw a weekly salary of $50 and expenses, however. By the fall of 1939 the Bluegray Company had extended $8,000 in credit to the store, only one-quarter of which was covered by stock on hand. At this time the Bluegray Company took over the operation of the store as a part of its own chain, hoping thereby to salvage some of its investment in the venture.

EXHIBIT 5
BLUEGRAY COMPANY
Percentage Breakdown of Sales by Types of Outlet, 1933–1939

	1933	1934	1935	1936	1937	1938	1939
Industrial and Miscellaneous	40%	40%	39%	40%	38%	39%	37%
Lumber Dealers	19	20	26	24	26	25	28
Other Dealers	9	11	6	6	4	4	4
Associate Stores	.....	.....	1	2	3	6	6
Company Stores	32	29	28	28	29	26	25
Total	100%	100%	100%	100%	100%	100%	100%

In May, 1938, another salesman left the company and wished to set up an associate store; but he had capital of only $1,500. The Bluegray executives believed that this amount of capital was probably too small, but they finally agreed to sell the man merchandise on the associate-store basis and to take the $1,500 in payment. By the end of 1939, the manager had not been able to pay any more toward the cost of his stock because he needed money for living expenses; in fact, he had received further credit until he owed the company $5,000.

In reviewing the three types of nonindustrial distribution used by the company the president was aware that each type had certain advantages and disadvantages. In selling to dealers the

company received the largest gross margin, estimated in 1939 at 42%; but it also incurred the highest expense of selling, 20%. The company-owned stores had the advantage of assuring the company of aggressive merchandising to painters, but they had the dis-

EXHIBIT 6
BLUEGRAY COMPANY
Operating Statement for All Company-Owned Stores, 1939

Gross Sales		$274,402.20
Less Returns		12,680.45
Net Sales		$261,721.75
Cost of Sales		144,039.77
Gross Profit		$117,681.98
Selling Expense:		
Salaries	$42,799.20	
Rent	10,661.90	
Traveling	8,589.16	
Other	35,441.54	97,491.80
Sales Profit		$ 20,190.18
Less Administrative Expense		21,094.65
Operating Loss		$ 904.47

advantage of requiring even more capital than dealerships. The Bluegray Company had insufficient capital for any great expansion of this kind, but in 1939 the company stores provided 25% of the total volume (see Exhibits 5, 6, and 7). Mr. Johnson considered the possibility of selling some of the company stores to the managers as a means of obtaining capital for further expansion, but he found that none of the managers was in a financial position to buy a store. The associate-store plan offered the major advantages of

EXHIBIT 7
BLUEGRAY COMPANY
Miscellaneous Operating Statistics for All Company-Owned Stores, 1939

	Best Showing	Poorest Showing
Stock-turn:		
Total	9.0 Times a Year	5.0 Times a Year
Paint	10.2 Times a Year	4.4 Times a Year
Wallpaper	6.8 Times a Year	2.9 Times a Year
Store Managers' Compensation	12.0% of Net Sales	28.0% of Net Sales
Total Store Expense	32.4% of Net Sales	56.0% of Net Sales

insuring aggressive pushing of the company's products and yet requiring only a small amount of capital. The president believed that the company was in a good position to operate associate stores because of its experience with its own stores. He was convinced

that, when all facts were considered, the associate-store plan was best suited to the Bluegray Company.

Nevertheless, there still remained the problem of finding suitable prospects. The advertising manager, who was in charge of the associate stores, had advertised in newspapers and called on bankers in likely towns; but he had found few men with the proper qualifications. A good prospect needed to have $5,000 in capital. A community was not canvassed unless potential sales of at least $15,000 to $16,000 were available annually, because executives were convinced that this volume of business was necessary for a profit in either a company store or an associate store. This fact was demonstrated by the 1939 operating statement of Associate Store No. 4, as compared with the operating statement of one of the company stores in a town of similar size (see Exhibits 8 and 9).

EXHIBIT 8
BLUEGRAY COMPANY
Operating Statement for Associate Store No. 4, 1939

Gross Sales		$8,266.14
Less Returns		463.53
Net Sales		$7,802.61
Cost of Sales		5,019.70
Gross Profit		$2,782.91
Selling Expense:		
Salaries	$2,977.01	
Rent	720.00	
Traveling	541.15	
Other	1,491.44	5,729.60
Sales Loss		$2,946.69

EXHIBIT 9
BLUEGRAY COMPANY
Operating Statement for Company Store No. 8, 1939

Gross Sales		$16,581.88
Less Returns		522.38
Net Sales		$16,059.50
Cost of Sales		8,780.24
Gross Profit		$ 7,279.26
Selling Expense:		
Salaries	$2,900.60	
Rent	420.00	
Traveling	678.00	
Other	1,842.39	5,840.99
Sales Profit		$ 1,438.27
Less Administrative Expense		1,261.68
Operating Profit		$ 176.59

An objection which a prospect frequently raised to investing capital in an associate store was the seasonal nature of the business. The company estimated that 40% of the sales of its own stores came in April, May, and June; September and October were good months; March, July, August, and November were fair; and December, January, and February were very poor. In spite of this objection to specialized paint stores, however, the president noted that several of the larger paint companies had established stores in his company's trading area in 1939. He believed that this move would intensify competition and that, if the Bluegray Company was to maintain its position as a large supplier of paints in the area, it would have to install more company stores or associate stores to push the company's line aggressively.

Early in 1938 an attempt had been made to interest the Pever Hardware Company in a dealer franchise; but even though this store was dissatisfied with its connection with a manufacturer of a national brand of paint, it had decided against stocking the Bluegray line. This store sold $40,000 to $50,000 worth of paint annually and was considered the leading hardware store in the city of 30,000 in which it was located. The Bluegray Company was very eager to obtain this account; and in the summer of 1938 the executives explained the associate-store plan to the manager of the Pever company, who at this time agreed to take on the wallpaper under the plan of allowed returns. The Bluegray advertising manager continued his solicitation of the store's paint business regularly for almost two years; and finally in January, 1940, the Pever company agreed to stock paint under the associate-store arrangement. The Pever company was to receive the associate-store discount and operate under the conditions set forth in the associate-store plan, except that the Pever company's own identity was to be maintained. Not even the clerks in the paint department of the Pever company were to know that the arrangement was not a regular dealership.

4. CONNOR COMPANY

MARKETING PROGRAM

In 1936 a salesman of the Connor Company, which manufactured branded, minor internal parts for automobile engines, suggested to the executive officers that the distribution policy of the company be revised to permit sales to chain variety stores, chain automobile-accessories stores, and mail-order houses. Through its salesforce of seven salesmen the company made sales of its parts to automobile manufacturers and also to replacement-parts wholesalers, who resold the product to car dealers, garage operators, and

EXHIBIT 1
CONNOR COMPANY
Summary of Wholesale Distribution

Year	Number of Distribution Centers	Number of Wholesalers	Average Annual Volume per Wholesaler
1928	379	766	$241
1929	566	902	262
1930	483	968	245
1931	518	957	255
1932	541	949	221
1933	515	988	221
1934	537	1,056	217
1935	545	1,110	211

independent repairmen. Of the company's total sales of over $500,000, from 50% to 60% were made directly to automobile manufacturers. Sales to the wholesale outlets varied between 40% and 50% of total sales. The salesman, in his letter to the management, pointed out what he considered to be significant changes in the market for such products, and he urged the officers to review the entire distribution setup of the company.

In 1935 the company had 1,110 wholesalers of replacement parts in 545 cities in the United States. The changes in the number of distribution centers, the number of wholesalers, and the average annual sales volume of each wholesaler were as shown in Exhibit 1. The average volume of wholesalers was somewhat misleading, because there were a number of small towns in which few items were carried in stock by distributors, and their purchases

reduced the average. Of the 1,110 wholesale accounts, 27, or 2½% of the total, furnished 22.8% of the total sales volume; the average annual business for this group was $1,980 a year. Sixty-one more accounts, an additional 5½% of the total, furnished 14.8% of total sales; the average annual business for this group was $569. The remaining 1,022 accounts, or 92%, supplied 62.4% of the total sales volume; the average annual sales to this group were $143.

These wholesalers of parts and supplies were considered especially convenient for independent repairmen, who frequently had several makes of cars in their shops for repair at one time. If they were to purchase parts and supplies from car dealers handling these several makes, they would have to call on three different sources of supply. By buying from a replacement-parts wholesaler, however, they called on a single source either at his place of business or by telephone for delivery service. Notwithstanding the importance of this stock-carrying function from the standpoint of the repairmen, the facts were that the jobbers did not carry as large stocks as they should. To protect its sales volume, therefore, the Connor Company found it necessary to establish branch warehouses in several sections of the country in order to give prompt delivery to wholesalers who were out of stock. In 1928, 11% of the total sales of the Connor Company to wholesalers were shipped from warehouse stocks, and 89% from the factory. By 1935 the percentage of sales shipped from the warehouse stocks had risen to 38.3%.

According to the memorandum of the salesman, several factors were affecting the current problem of the company. In the first place, the automobile manufacturers were showing more interest in the control of the repair business on cars already sold. Secondly, there was an increase in the number of original-parts manufacturers who sought outlets. This situation had led, in the opinion of the salesman, to an oversupply of replacement-parts wholesalers. Thirdly, cut-rate accessories stores, both independent units and chains, had secured unbranded lines of parts and accessories for resale to the car dealer, garage man, or car owner at prices below those quoted on the branded products either by automobile manufacturers who sold replacement parts to their dealers or by the wholesalers who offered these branded parts to repairmen. The salesman believed that these cut-rate stores were securing an increasing proportion of the business of car dealers who used

unbranded parts in repairing traded-in cars. Fourthly, the super-service, one-stop stations of the Firestone Tire & Rubber Company, the Shell Petroleum Company, the Goodyear Tire & Rubber Company, and the Standard Oil units in several sections of the country were adding parts and accessories to their lines and were doing repair jobs for automobile owners. Finally, the independent repairmen were demanding larger discounts from list prices; and because of the shrinking market among wholesalers, the repairmen were able to play one wholesaler against another.

Originally, automobile manufacturers had concentrated on sales of cars with little regard for the service and repair end of the business. They offered supplies of repair parts to their dealers, but usually they placed high selling prices on these parts. The original producer of the parts or supplies, by copying the automobile manufacturer's resale prices for parts, was able to offer to wholesale outlets seeking replacement-parts business discounts from the manufacturer's prices. For instance, the Connor Company used the car maker's list prices for replacements. For most items in the line the Connor Company allowed wholesalers a 60% discount from list prices. Full freight was allowed on shipments of 100 pounds or more. Terms were 2%, 10 days, net, 30 days, for established accounts. Wholesalers were expected to resell Connor products to car dealers and independent repairmen for 40% off the list price, when the purchaser bought standard cartons. In less than carton lots, suggested discounts to dealers were either 25% or 30% off list. After the depression began in 1930, on account of the decline in unit sales of cars automobile manufacturers generally made a greater effort to control the repair business on cars already sold; whereas formerly car makers insisted that their dealers carry some repair parts and supplies, they did not allow so large a discount from list as did the replacement-parts wholesalers. By 1936, however, many car makers were allowing their dealers discounts as high as 40% to 42% from manufacturers' list prices on genuine branded parts. In one instance, furthermore, a car builder was forcing key retail dealers to operate trucks for the distribution of parts to independent repairmen. The driver of the truck sold, delivered, and collected at one time for genuine parts and supplies; the repairman was given a discount of 28% off the manufacturers' list prices. The salesman thought that this competition from car manufacturers in repair parts and their insistence that dealers carry more adequate stocks

of parts purchased from the car builder had led to some shrinkage in the sales of replacement-parts wholesalers to car dealers. The management had no reliable data to indicate whether this statement was true. The only survey which the management had available showed that car dealers purchased about 30% of their requirements from wholesalers. The officers had an impression that the 30% was high, but they had no means of knowing how it compared with the figure for previous years.

The changes between 1929 and 1933 in automotive-equipment wholesaling, including accessories and parts, were summarized in the Wholesale Census for 1933. The total number of wholesalers increased from 2,570 firms in 1929 to 4,251 firms in 1933, whereas the sales in 1929 were $399,797,000 and the sales in 1933 were $246,280,000, or a decline of 38.4%. A typical wholesale firm carried as many as 200 different lines of replacement parts. Its salesmen called on customers and installed whatever equipment was necessary for the completion of service, and the firm gave delivery service to automobile dealers and independent repairmen. The salesman stated that the increase in the number of wholesalers had resulted in smaller territories, the addition of lines other than parts, an increase in inventories relative to sales, larger overhead and consequently smaller profits for the wholesalers, and a shading of resale discounts as a means of obtaining business. The total expense reported in the census for automotive-equipment and parts wholesalers was 29.2% in 1933, whereas in 1929 it had been slightly over 24%.

The cut-rate automobile-accessories stores, described by the salesman as chains or as large individually owned and operated units including mail-order houses, secured unbranded lines of parts and accessories for resale to the car dealer, garage man, or car owner at prices comparable to or lower than the net prices paid by customers of parts wholesalers. The Retail Census for 1933 listed 58 automobile-accessories chains with 1,098 units and a sales volume of nearly $52,000,000 in contrast to the 1929 figures of 52 chains with 855 units and sales of $59,486,000. Sales of automobile accessories by mail-order companies were estimated to be nearly as large as the sales by specialized accessory chains. The cut-rate accessories stores, according to the salesman, had low sales expense for the combined function of wholesaling and retailing (estimated from census reports for 1933 as about 32%),

used newspaper advertising, and sometimes issued catalogues showing net prices instead of list prices less discounts. These catalogues were mailed direct to any prospect. The salesman stated that these stores were obtaining an increasing amount of car dealer business, especially for parts and supplies to be used on cars traded in.

In the opinion of the salesman, the superservice stations were not yet important competitors of the parts wholesalers, but they were likely to become so. They were able to solicit the car owners' repair business more often than other types of outlets because of the customers' frequency of call for gasoline and oil.

The replacement-parts wholesalers, according to the salesman, were in danger of losing the car dealer business altogether, and the independent repairmen were demanding larger discounts from list prices, because the chains offered them lower net prices. These repairmen frequently were poor credit risks. Often they were ill equipped to do a general line of repair work; they carried no stocks, buying only what they needed as they needed it. They usually did no advertising, ignored the sales helps furnished by the wholesaler, and generally lacked aggressiveness. The salesman thought that in many instances the repairmen passed their discounts on to the car owner, doing work only for the labor costs involved. The wholesaler of branded parts had protected the repairmen by upholding list prices and, in general, had refused to sell to car owners at a discount. The result of this policy was that the parts wholesalers were considered a high-price source of supply by the car owner who wished to make his own minor repairs, and consequently these customers had purchased from the cut-rate accessories stores.

The officers of the company received the suggestions of the salesman with interest and consented to review the distribution policy of the company. The records of the home office, however, indicated that the problem of selling to chains was not an urgent one. The total sales to wholesale outlets from 1929 to 1935 had been as follows:

1929	$236,000
1930	236,000
1931	244,000
1932	210,000
1933	218,000
1934	229,000
1935	235,000

There had been an average reduction in prices of 10% in the fall of 1931, and a further reduction of 15% on the average in the spring of 1933. There had been no price advances since that time. The executives pointed out that, in spite of these reductions, sales had been maintained in volume. The record of unit sales, moreover, showed that the company had increased its sales. The officers had no way of knowing, however, whether their position in the industry was better than, equal to, or worse than formerly, because sales for the industry as a whole were not available. They agreed, nevertheless, that internal records did not justify immediate sales to the chain stores, except on terms reasonably satisfactory to the company.

Of the more than 50 chains listed in the census reports, one officer thought that perhaps 10 of the size of the mail-order chains and the larger accessories chains were the only ones from which the company should consider initially soliciting business.

A previous experience in selling to an automobile-accessories chain had not been wholly satisfactory from the standpoint of the management. The company, on that occasion, had sold its branded line of merchandise on the understanding that the chain would quote net prices rather than list less a discount. It had been agreed, however, that the net price quoted by the accessories chain was not to be below the actual net selling price of the replacement-parts wholesalers. The Connor Company sold to the chain at list less 60%, the same price that wholesalers paid. The chain organization actually quoted prices 17½% lower than agreed upon. When the executives of the chain were asked to explain the failure to fulfill the agreement, they reported that a change in personnel had accounted for the error. The officials of the Connor Company, nevertheless, fearing an unfavorable reaction from replacement-parts wholesalers, refused to sell further supplies to the chain. As a matter of fact, the Connor Company received no complaints from the wholesalers. The management did not know whether the failure to receive complaints was because there was no ill feeling or whether complaints had been avoided because company salesmen had informed jobbers of the action of the company in refusing to sell further to the chain.

In 1936, when a chain store requested a quotation from the company, the executives of the chain organization indicated that they were not willing to maintain the suggested resale prices of the manufacturer. The management of the Connor Company

believed that the chain wished to sell at a price at least 10% below the net price of replacement-parts wholesalers. Since the chain wished to sell at a lower price than wholesalers, it was not content to buy at the same price as wholesalers paid. Thus, if the Connor Company decided to quote to the chain, it was probable that it would have to quote a lower net price. To offset this lower price, there was the fact that the estimated volume of this chain would be $4,000 to $5,000 a year in contrast to the volume of the larger wholesalers, which averaged $1,980 a year. On the sales to wholesalers, the treasurer of the Connor Company stated that the selling expense, including advertising, warehousing, prepaid freight, salesmen's salaries, commissions, and so on, was 28.5% of sales. General administrative expense allocated to sales to wholesalers was an additional 8.5% of sales. For many years the company had advertised in some 20 trade magazines, such as *Motor*, *Motor Service*, *Motor Digest*, *Fleet*, and *Truck Operators' Digest*, at an average cost of 7% of sales. If the company made sales to the chain stores, the officers anticipated no economy in advertising expense of any consequence. But the cost of personal solicitation by salesmen would be small, because the salesmen would not have to check stocks in the chain, and the negotiation of contracts would be largely an executive matter.

One of the officers contended that sales to chains at lower prices would encourage a reduction in the level of resale prices. Such a reduction, he argued, would tend to undermine existing channels of distribution. He admitted that such risks might be reduced somewhat if the company sold its parts to the chain stores under the brand of the chains or unbranded. The company could afford to place a distributor's brand on the products without affecting its total cost of production. This officer stated that the company had advertised to the trade for so many years that it had established recognition for the quality of its products with car dealers and with independent repairmen. He thought that the company should not sell unbranded or private-brand products and thereby lose its investment in goodwill.

One of the officers investigated the source of supply used by the chain store and found that the manufacturer who furnished the chain had no other retail or wholesale distribution. Except for the chain store business, this manufacturer sold only to industrial customers. The Connor Company, in dealing with the chain,

had a trade name to offer, and its product was estimated to be superior to that of the other manufacturers; that is, the manufacturing cost, given approximate equivalence in efficiency, was judged to be 20% greater for the Connor product than for the other products.

5. KAUL COMPANY

MARKETING PROGRAM

In 1938 the officers of the Kaul Company, a long-established manufacturer of a limited line of machine tools, were seeking to determine what changes, if any, should be made in the company's methods of marketing its automatic lubricating system. With a view to developing products which would have less violent cyclical fluctuations in sales than machine tools, the company's executives had begun experimental work on a new type of automatic lubricating system in 1928. By 1931 a patent had been secured, and a working model had been demonstrated at a machinery exhibition. Continued work on the mechanical features of the system delayed active marketing efforts until 1933. Various unforeseen difficulties were encountered in marketing the product, and in consequence the company had not succeeded in making a profit on the sales of the automatic lubricating system in any year from 1933 through 1938.

The Kaul automatic lubricating system consisted of a central pumping unit, pressure-responsive self-cleaning feeder valves, and tubing connecting the pump with the feeder valves. It could be adapted to any machine that required lubrication, regardless of the size of the machine, the number of bearings, and the total oil requirements of each. The lubricating system could be built in as an integral part of a new machine, or it could be installed on existing plant machinery by attachment either to individual machines or to groups of machines. A Kaul system, moreover, could be adjusted to deliver oil to some bearings under pressure and to other bearings by gravity feed. At the same time it could maintain continuously circulating flood lubrication to other bearings and gears. Any engine or machine oil of mineral origin which was free-flowing at minimum operating temperatures could be used in the Kaul system.

The Kaul lubricating system could be used on many different kinds of machines, including machine tools, printing presses, calenders, driers, tenter frames, horizontal pumps, and headers for making nuts and bolts. An estimate of the size of the potential market for Kaul equipment on certain selected types of machines is given in Exhibit 1.

The outstanding advantage of the Kaul lubricating system was the increase in the productive time of machinery. After the

EXHIBIT 1
KAUL COMPANY
Estimated Potential Market for Kaul Equipment, by Selected Types of Machines, 1935

	Total Unit Sales by Industry*	Average Price per Machine*	Prices of Parts Sold by Kaul to Equip One Machine	Total Possible Sales of Kaul Parts
Broaching Machines	219	$3,050	$ 75†	$ 16,425
Vertical Multiple Spindle Drills	788	2,230	75	59,100
Gear Cutting Machines	896	5,150	90	80,640
Automatic Screw Machines	511	5,815	100	51,100
Turret Lathes	936	3,443	90	84,240
Cylinder Presses	510	4,060	$300–$1,200 (av. $750)	382,500

* Source: U.S. Bureau of the Census, *Biennial Census of Manufactures, 1935* (Washington, Government Printing Office, 1938). (Average price computed by dividing total value by number of machines.)

† On a broaching machine, for instance, the Kaul Company would make a sale averaging $75 for each lubricating system installed by an original equipment maker. This sale would include pumps and feeders.

installation of an automatic lubricating system, time formerly devoted to oiling by hand could be used for operation or make-ready. One printing firm, which had installed the system on three of its presses, reported that the time required for oiling had been reduced from 4.6% of the total operating time of the press to 0.7%. Because of this increase in the productive time of the press, the printing company estimated that the system would save its total cost in one year. Another major advantage of the Kaul system was that bearings received the required amount of oil in small quantities at regular intervals instead of large quantities at irregular intervals. Fewer burned-out bearings, longer life for machinery, and less loss of time for repairs resulted from automatic lubrication.

The officers believed that the need for automatic lubrication had steadily become more important throughout the period from 1928 to 1938. Machine speeds were being stepped up, with an increased risk of burned-out bearings if hand oiling was relied on.

Because of the redesigning of machine tools to give them a streamlined appearance, many operating parts were being fully enclosed. These enclosed parts made automatic lubrication essential. Many continuous-process machines, which were developed during the decade, could not be operated effectively without automatic lubrication, because the success of continuous-process manufacturing depended on the unfailing functioning of all parts of the process.

The officers of the Kaul Company at first sought to distribute the automatic lubricating system through the channels previously used for machine tools, but they soon discovered that it was not possible to do so. About 125 machinery dealers or manufacturers' agents represented the company throughout the United States for the sale of machine tools. Since these organizations were accustomed to selling machines of high unit value, they were not interested in selling the automatic lubricating system, the unit sales of which were relatively small. The manufacturers' agents, moreover, were not equipped either to render the engineering service required in connection with installations of the system or to provide the repair service necessary for insuring satisfactory operation. The executives of the Kaul Company were thoroughly familiar with the machine tool industry; and the chief engineer, who had designed the lubricating system, therefore undertook to convince machine tool manufacturers of the desirability of incorporating the lubricating system in their equipment. Although some of these manufacturers were willing to install the system if the customer asked for it and paid extra for it, they would not take the initiative in installing it and would not make the effort to convince their customers that the system would be desirable to have on the machines.

As part of its program of familiarizing machinery users with the advantages of the Kaul system, the company made a few trial installations. Although only one customer returned the equipment at the end of the trial period, the Kaul Company discontinued the practice because of the heavy expense involved. The company continued to work actively with machinery users to induce them to

specify Kaul systems in their purchases of new equipment and to install systems on existing equipment. The company also endeavored to cooperate fully with machinery manufacturers in adapting the system to their machinery when it was specified by customers. Frequently the cost of the selling and engineering effort used in completing an initial sale greatly exceeded the gross margin on the transaction.

On sales to users of machinery the Kaul Company assumed the responsibility for installation and therefore quoted an installed price. This price was built up by determining the size of the pumping unit required, the quantity of tubing needed, and the number of bearings to be equipped with feeder valves. The feeder valves with a window were priced at $1.50 each, while the feeder valves without windows were sold for 90 cents each. The pumping units normally were priced between $27 and $45, although on a few installations where a number of machines were to be served by the same lubricating system the price of the pumping unit had been as high as $300. Tubing costs ranged from 5 cents to 10 cents a foot. Installation costs, figured at $15 a day for each mechanic, averaged between $25 and $60 for a system. Since the price of parts averaged between $75 and $90 for an installation, the total cost for the typical installation was between $100 and $150. The lowest-price installation which the company had ever made was $50, whereas the highest was $1,500. On such machinery as paper driers and tenter frames, the total cost of Kaul equipment needed to provide full lubrication was in the range of $1,000 to $1,500.

To machinery manufacturers the company sold only the pumping units and the feeder valves. Prices for these parts were the same as those quoted to machinery users. The expense to the machinery manufacturers of incorporating the system in a machine during its assembly was only half as great as the cost of installing it on a machine already built, for in the latter case it was necessary partly to dismantle the machine in order to install the system.

The original efforts to sell the Kaul system were made by the chief engineer, but by 1938 the company had six salesmen located in large industrial centers. Usually these men shared offices and the services of a secretary with the salesmen of other companies. The Kaul Company paid its share of this office expense.

All salesmen had been trained in the Kaul Company's plant and were able to determine the feasibility of using Kaul systems

on the equipment in operation, to plan layouts for the installation of the lubricating system, to figure prices, and to install systems. In the event that difficulties occurred in the operation of the system, the salesmen were able to render prompt repair service because they were willing to put on overalls and do the work themselves.

Salesmen were paid commissions of 33⅓% of their sales of the parts of the lubricating system manufactured by the Kaul Company. In other words, no commissions were allowed on sales of materials purchased from other manufacturers or on installation charges. The commission rate applied to repeat orders as well as to the initial order. Salesmen were guaranteed a minimum drawing account of $50 a week. No salesman had earned commissions in excess of his drawing account in any year from 1933 to 1938. Since traveling expenses averaged $1,500 a year for a salesman, the total outlay of the Kaul Company for its salesforce was approximately $24,000 in 1938. The company had been able partly to finance the excess drawings of salesmen beyond earned commissions from the gross margin realized on sales made to the two largest customers. These accounts had been obtained before salesmen were placed in the field, and consequently the company had paid no commissions on sales to these accounts.

The Kaul Company had not been able to earn a profit on the sale of lubricating systems in any year from 1933 to 1938. Operating statements for 1935, 1936, and 1937 are given in Exhibit 2. All the expenses of the lubricating system department were directly attributable to the sale of the lubricating system. This department therefore had provided no contribution to the fixed expenses of the Kaul Company as a whole.

By 1938, three-quarters of the sales of the Kaul Company were made to machinery manufacturers. In approaching such companies, salesmen found it necessary to make contacts with a number of executives. The initial visit seldom resulted in a sale but frequently paved the way for a second visit, during which the salesman demonstrated a miniature automatic lubricating system. This miniature system had been found to be an effective method of securing the interest of plant engineers. In fact, it was often the reason why a second interview was granted. Normally, additional calls were necessary before the engineering department would approve the product for use in machines. Even after the system had been approved by the engineering department, a year or two

often elapsed before the machines were redesigned so that the lubricating system could be made an integral part. Obviously the cost of making such first sales was great, and the Kaul Company could not hope to make a profit unless repeat orders were secured. When these repeat orders came in by mail, under the existing arrangement the salesmen received their usual commissions of 33⅓%.

In soliciting business from machinery users, salesmen were confronted with the difficulty that the typical user had in his plant a variety of machines. It was necessary, therefore, for the salesman to spend substantial time in working out the details of

Exhibit 2
Kaul Company
Operating Statements, 1935–1937

	1935	1936	1937
Gross Sales	$37,000	$57,000	$82,000
Cost of Goods Sold	22,000	30,000	44,000
Gross Margin	$15,000	$27,000	$38,000
Selling and Administrative Expense	$22,000	$26,000	$28,000
Advertising and Sales Promotion Expense	7,000	13,000	12,000
Total Expense	$29,000	$39,000	$40,000
Net Loss	$14,000	$12,000	$ 2,000

the installation for each type of machine. Since there was little likelihood of repeat orders on identical equipment, the cost of obtaining this business was very high in relation to sales.

During 1933 and 1934 the Kaul Company's efforts at sales promotion were limited to bulletins describing the automatic lubricating system. These bulletins were not well prepared, did not emphasize the significant advantages of the system, and did not include descriptions of successful applications. During 1935 and 1936 the company regularly inserted quarter-page advertisements in *Modern Machine Shop* and *American Machinist* and half-page advertisements in *Product Engineering*, *Machine Design*, and *Plant Equipment Engineer*. No publication advertising was done in 1937 and 1938. Throughout this period most of the appropriation for sales promotion was used for the distribution of direct-mail materials. In 1938 the company issued a carefully prepared catalogue

describing the automatic lubricating system. The catalogue contained a complete description of the system and its advantages and presented exceptionally well-executed illustrations of the system in operation. The drawings and specifications in the catalogue were such that a plant engineer could obtain a thorough understanding of the principles of the system. The catalogue was included in a published file in 1938 at a cost of approximately $3,000. This file was distributed to the offices of about 4,000 engineers.

6. BOSTON WIRE STITCHER COMPANY

MARKETING PROGRAM

The Boston Wire Stitcher Company was a manufacturer of heavy hand and power stitching machines for printers, bookbinders, and boxmakers and of light stapling machines and staples for office use. The first group, which included automatic box stitchers, multiple-head stitchers, and similar large machines, were sold through agents at prices ranging from $200 to $6,500 each; large special-order machines often sold for $25,000 or more. The light stapling machines, developed in 1923, were sold direct and through agents to users at prices ranging from $3.50 to $17, although a few large ones for industrial use were priced as high as $90. From 1923 to 1934, over 1,000,000 of the stapling machines had been distributed.

In 1934 the Boston Wire Stitcher Company made most of its sales of light stapling machines and staples direct to industrial users and offices through a wholly owned subsidiary, the Bostitch Sales Company, and through established, authorized distributors. For sales to stationers and the retail trade, its only outlet was the National Distributing Company, which sold under its own brand a special desk stapler and staples to fill the machine. Before 1930 the Boston Wire Stitcher Company had made all sales of staples and stapling machines through a selling agency. In 1930, however, it organized the Bostitch Sales Company; and the latter company then bought the agency, took over its personnel, and organized separately incorporated branches in Boston, New York, Chicago, St. Louis, and Montreal. Managers of these branches also controlled salesmen operating from over 35 other cities. In each of

these cities, the Bostitch Sales Company allowed the salesmen to have desk space and a telephone connection at the company's expense. In 10 cities of the United States and in 29 foreign countries, the Bostitch Sales Company had established authorized exclusive distributors who were given one-year contracts and who were required to carry their own stocks. Nearly all these distributors sold the Bostitch line exclusively.

The Bostitch Sales Company was represented by over 90 salesmen of its branches and by 80 salesmen of the distributors. Salesmen were thoroughly trained in the merits of Bostitch products and could explain convincingly to potential users features of Bostitch staples, such as the advantages of flexible staples, and utility in operation of uniform-size wire and cleanly cut points. Both groups of salesmen received commissions of 35% of the company's list price on small orders, but the commission decreased progressively as the quantity of the order became larger and the sales price smaller. The following list shows the commissions granted on one type of staple with prices ranging, according to the quantity ordered, from $1 to $2.

Price per Box	Commission per Box
$2.00	$0.70
1.90	0.65
1.80	0.60
1.70	0.55
1.60	0.50
1.50	0.45
1.40	0.40
1.30	0.30
1.20	0.25
1.10	0.20
1.00	0.15

Although by July, 1934, the unit volume of sales had not changed perceptibly from the level of earlier years, dollar sales had dropped 60%. Salesmen therefore suffered a marked decline in earnings. Men who before the depression had earned as much as $60 a week in the larger cities, or $45 to $50 in less populous areas, averaged $35 a week in large cities and less in smaller cities in 1934.

For several years before 1934, in order to supplement the work of the salesmen, the Bostitch Sales Company had spent over $40,000 annually on advertising its stapling machines under the Bostitch name. It used such media as *The Saturday Evening Post*, *Time*,

Collier's, the trade journals of industries in which there were potential customers for stapling machines, and direct mail.

The Bostitch Sales Company derived the greater part of its revenue from the sales of refills for its stapling machines. The replacement demand for staples was steady, whereas the replacement demand for machines was infrequent. In August, 1934, staples sold under the Bostitch name amounted to approximately 25% of the total sales of the industry. At this time, the Bostitch Sales Company was the only company selling direct to users; competitors were selling through retail stationers and office-supply dealers.

In the summer of 1934, the executives of the Boston Wire Stitcher Company were trying to determine why the company had not obtained a larger share of the market for staples. A major difficulty appeared to be that, although the Bostitch sales organization sold stapling machines to both large and small users, it failed to obtain repeat business on staples from the customers whose demand was small. Salesmen normally sought repeat orders on staples from firms buying in large enough quantities to yield an aggregate commission that would justify the time of a call. In seeking replacement business on machines, however, the salesmen did obtain a large number of small orders for staples. As a result of the activities of salesmen, the refill demands of the smaller customers tended to go to stationers, none of whom carried supplies under the Bostitch brand. Furthermore, the company's only distributor to stationers, the National Distributing Company, which sold the Bostitch product under its own brand, had found difficulty in competing for the trade of the stationers against other staple manufacturers. In contrast to 8 companies making stapling machines, there were 30 companies manufacturing staples, with the result that competition was keen. Staple manufacturers sold to stationers at prices up to 25% under the quotations of the National Distributing Company. The latter company, however, in the opinion of the executives of the Bostitch Sales Company, actually sold staples for a price 10% lower than one which would cover its normal markup.

The officials of the Boston Wire Stitcher Company asked a marketing consultant for his opinion on the problem of increasing sales volume of staples. After studying the situation for several months, the consultant recommended that the company sell staples

under the Bostitch name directly to stationers. In this way the benefit of Bostitch national advertising could be carried over to the stationer. He also advised that the Bostitch Sales Company stop selling to the National Distributing Company for the latter's private brand. He believed that the National Distributing Company could never expand sales under the existing setup because it functioned as an extra middleman between producer and retailer. Even if that company were able to sell staples in large quantities, the Bostitch Sales Company would not be benefited in the long run, since the name of the distributing company and not the Bostitch name would be associated with the product.

The executives expressed a number of objections to the plan of the marketing consultant. In the first place, they hesitated to follow his advice because the company had always had friendly relations with the National Distributing Company. An important objection to the plan, moreover, was the fact that stationers could not be depended on to maintain prices set by the Bostitch Sales Company; these prices for small quantities were nearly 20% higher than those charged for approximately comparable merchandise by retail stationers. The suggested schedule of consumer prices for a standard Bostitch staple made of No. 19 wire with a ½-inch crown and ¼-inch length, as of June 30, 1934, was as follows:

Number of Boxes (5,000 staples to a box)	Suggested Consumer Price per Box
0— 4	$1.50
5— 9	1.40
10— 19	1.35
20— 39	1.30
40— 79	1.20
80— 99	1.15
100—199	1.05
200—499	0.95
500—999	0.85
1,000 and over	0.70

The retail stationer ordinarily sold only a few boxes of staples at a time, but he was able to buy staples from other companies at 50 cents to 75 cents a box, depending on the quantities involved. The salesmen of the Bostitch Sales Company had had no difficulty in obtaining list prices from their regular customers, but there was a question whether direct-sale list prices could be maintained if stationers were allowed to carry staples bearing the Bostitch name

and selling at lower prices. These same objections applied to a proposal to allow the National Distributing Company to sell staples under the Bostitch name.

The executives, on the other hand, also recognized that there were favorable aspects to the recommendations. The company estimated that nearly 1,800 of at least 3,600 retail stationers could be considered good credit risks. Although the officers did not expect that an increase in production would lower unit manufacturing costs, there was every indication that added volume would reduce sales expenses, since approximately half the sales expense was relatively fixed. Typical operating figures for a sales branch were as follows: sales, $100,000; cost of sales, $45,000 to $50,000; expenses, including allocated home-office overhead of the Bostitch Sales Company, $45,000 to $50,000. The size of orders expected from stationers was larger than those currently received from the established Bostitch business, for the average order obtained by the Bostitch salesforce for staples was only $7. Thus, any increased sales volume was expected to decrease the unit sales expense. An increase of the Bostitch Sales Company's share of the market for staples from 25% to 35% would mean a 40% increase in its own sales and a substantial additional net profit.

7. DEARBORN ELECTRICAL SUPPLY COMPANY

MARKETING PROGRAM

The Dearborn Electrical Supply Company had been established before 1900 as a contractor-dealer. Although its primary business at that time was the wiring of factories, houses, and office buildings, opportunities developed through these wiring contracts enabled the company to sell electrical supplies, such as switches, fuses, sockets, and electric light bulbs, to industrial plants. Some years later, when it became evident that purchasing agents of industrial plants were placing their orders for electrical supplies with wholesalers rather than with contractor-dealers, the company established a wholesale department in order to retain its industrial business. By 1920 the company was primarily a wholesale firm. Between 1920 and 1930 electrical appliances, radios, and refrigerators were added to existing lines in an effort to offset declining sales of supplies

caused by increasing competition from other wholesalers of electrical goods of this type. During this 10-year period the company pursued a variety of product and marketing policies, the details of which are given in the paragraphs following.

In 1920 the company added electrical appliances, such as irons, toasters, and washing machines, because officials desired to lessen the company's dependence on the market for electrical supplies and because appliances could be sold to contractor-dealers by the same salesmen who sold them electrical supplies. The depression of 1921 caused a sharp drop in sales, and the company did not fully recover from the effects until 1924. Radios were added in 1924, partly for the same reasons that led to adding appliances and partly because the selling of radios appeared to be a profitable field for the company to enter.

The company segregated its retail business in 1927 and began operating it as the Dearborn Company. Although the retail and the wholesale departments had separate corporate identities thereafter and were in different parts of the same city, they were closely coordinated because the original founder of the business owned and directed both companies. The Dearborn Company took over retail, repair, and contract sales. Retail sales included over-the-counter sales to consumers of electrical supplies and appliances. Repair sales consisted of electrical repair work done in houses, offices, and other buildings. Contract sales represented the installation of wiring and fixtures in industrial plants, and other large construction jobs. The Dearborn Company made a profit from the beginning.

An exclusive agency for a nationally advertised brand of electric refrigerators was secured by the wholesale company in 1928. These products carried a markup of 15% to 20%. Although some utilities insisted on having exclusive agencies, refrigerator retailers in general were not protected. In 1929 the company sought to expand refrigerator sales aggressively because the sales volume had not been sufficient to cover the heavy expenses incurred. Later in the year, however, the company and the manufacturer were unable to agree on the extent of selling work which the company was to do on refrigerators; hence the line was dropped.

The retail company also added electric refrigerators in 1928 and continued to carry them after the wholesale unit gave up its agency at the end of 1929. In 1930 the retail company furthered its diver-

sification by adding furniture, gifts, lamps, and lamp shades. These new products were expected to attract into the store potential customers for electrical products.

In 1931 the Dearborn Electrical Supply Company was carrying four major product groups: appliances, fixtures, radios, and supplies.

Electrical appliances included such items as electric irons, toasters, washing machines, and small cord appliances. The wholesale company realized an average gross margin of only 20% on these articles because of its large sales to utility companies at reduced prices. Retail prices ranged from less than $1 on small items to over $100 on washing machines. Nearly all the appliances carried well-known brands, and brand changes were made infrequently. Utilities and department stores were the major outlets for these items.

Fixtures included a large variety of lighting fixtures. Prices varied widely, and the company realized an average gross margin of over 25% on practically all fixture sales. For these articles brand had little or no significance. The market was limited because of direct sale by manufacturers to large users.

The sales of radios had assumed considerable importance by 1931. Fada radios were carried in 1924, 1925, and 1926. On this brand the company had exclusive rights for a much larger territory than it normally covered. At the time the agency was granted, the company had expected to cultivate the entire territory covered by the agreement but found that it was unable to do so satisfactorily. The Fada line was replaced by Ever-ready radios in 1927. These sets were received unfavorably by consumers. Finally, the Crosley line was stocked in 1930 because the agency for the company's territory was available, the sets were reasonably priced, and the manufacturer backed his wholesalers with intensive promotion. The manufacturer had an oral agreement with each wholesaler that required the wholesaler to push Crosley sets to the exclusion of all other makes. The manufacturer, in return, agreed to cooperate on promotion and on the solution of sales problems. The Dearborn Electrical Supply Company did not grant exclusive agencies to retailers; sets were sold to practically any retailer who wanted to carry them. Retail prices ranged from $35 to $99.50. The wholesaler realized an average gross margin of 22.5%; retailers obtained 42.5%. Except for a few large firms, which purchased 50 or more sets a year, retailers bought an average of 12 sets a year.

Supplies included several thousand products, such as switches, wire, fittings, conduits, switchboxes, fuses, sockets, and electric light bulbs. The company's markup on these products varied from 5% to 75%, the average being between 20% and 25%. Although a few brands had gained recognition, for the most part standardization of electrical supply products had eliminated brand significance. Practically all items were carried from year to year without change. Normally, the principal market for electrical supplies was the industrial field, but contractor-dealers were becoming more important in 1931 because of the curtailment of large-scale industrial purchases. Sales were made almost entirely on the basis of price and service.

The wholesale company purchased merchandise from many sources. The purchasing agent handled all routine matters connected with purchasing, but the general manager laid down the general policies which were to be followed. Exclusive sales rights were held for products such as radios and washing machines, but most products were sold without territorial protection. The general manager authorized the addition of new items when favorable sales possibilities were indicated by the nature of the product, the attitude of the trade, or the experience of the retail store.

Selling prices for the most part conformed to those suggested by the manufacturers, although slight deviations were made occasionally to meet competitors' prices. All prices quoted were f.o.b. company's warehouse except in those instances where the merchandise sold was shipped direct from the manufacturer's plant. In such cases the purchaser paid transportation charges from that point. Credit terms were 2% until the tenth of the month following purchase, and bills not paid by that time were carried from 60 to 120 days.

In its pricing policy, the company allowed larger discounts to customers buying in quantities that conformed to the manufacturer's package than it did to those who purchased in broken packages. For some time the company had considered seriously the advisability of revising its schedule of quantity discounts. Executives realized that the accepted practice in various types of businesses was to grant to purchasers quantity discounts based on either the size of the individual order or the amount purchased over a period of time. Although discounts of the former type were more common in the wholesale electrical supply business, there

were occasional instances where patronage discounts were used. One officer favored strongly the adoption of a plan which would provide both types of discounts, while another took the position that the beginning of a depression was a poor time to experiment with discounts. At the middle of 1931 no decision had been made as to what action, if any, the company should take in this connection.

The sales promotional efforts of the company were very limited. Since no private brands had been developed, the president reasoned that competitors would benefit just as much as the company from any advertising that might be done. Even in the case of products for which the company held exclusive agencies expenditures for advertising were kept low because the president feared that the agency might be withdrawn before the company derived any benefit from the advertising. Consequently only a small expenditure for newspaper insertions was made; and chief reliance was placed on the use of direct-mail material, the mailing lists being compiled from local telephone directories. Special circulars were used to introduce new products, however, and window and counter displays supplied by manufacturers were installed in retail stores by the company's salesmen. Although one executive attempted to convince the president of the usefulness of advertising and other sales promotional methods in furthering sales of such products as the company carried, and emphasized the need of promotional efforts on the part of the company, the president remained firm in his decision not to depart from past policy.

The Dearborn Electrical Supply Company's market was concentrated within a 30-mile radius of the city in which the company's offices were maintained. In this area, location and transportation facilities enabled the company to give service and prices equal to or better than those of wholesalers located in other cities. If the salesmen went outside this area, they usually did so because the exclusive franchise on a product such as radios covered a wider territory.

The company's market included a large number of industrial plants and a railroad center of some importance. In this territory there was competition for business with five other wholesalers. Two of the competitors were wholesale branches of large electrical supply firms. One was a local wholesaler who specialized on sales to industry. The remaining two were contractor-dealers whose wholesale business was more or less incidental. In addition, the

Exhibit 1
Dearborn Electrical Supply Company
Operating Results and Sales by Product Groups, 1921–1930

Item	1921		1922		1923		1924		1925	
Operating Results:										
Total Sales	$284,074.96	100.0 %	$322,663.50	100.0 %	$470,502.59	100.0 %	$581,619.97	100.00 %	$603,863.54	100.00 %
Cost of Goods Sold	213,175.79	75.0	240,631.72	74.6	349,152.11	74.2	433,009.86	74.45	448,306.10	74.24
Gross Margin	$ 70,899.17	25.0 %	$ 82,031.78	25.4 %	$121,350.48	25.8 %	$148,610.11	25.55 %	$155,557.44	25.76 %
Total Expense*	108,448.99	38.2	109,060.73	33.8	129,480.13	27.5	135,164.26	23.24	134,419.93	22.26
Net Profit	$ 37,549.82†	13.2 %†	$ 27,028.95†	8.4 %†	$ 8,129.65†	1.7 %†	$ 13,445.85	2.31 %	$ 21,137.51	3.50 %
Other Income‡	12,048.59	4.2	14,057.09	4.4	13,417.79	3.0	6,689.27	1.15	11,288.80	1.87
Net Gain	$ 25,501.23†	9.0 %†	$ 12,971.86†	4.0 %†	$ 5,288.14	1.3 %	$ 20,135.12	3.46 %	$ 32,426.31	5.37 %
Sales by Product Groups:										
Retail Sales§	$ 9,833.06	3.5 %	$ 9,062.09	2.8 %	$ 9,277.09	2.0 %	$ 8,643.58	1.5 %	$ 8,509.25	1.4 %
Repair Sales	36,045.95	12.7	13,989.02	4.3	24,452.09	5.2	31,647.41	5.4	36,842.60	6.1
Contract Sales	23,670.67	8.3	52,720.78	16.4	64,908.10	13.8	88,297.10	15.2	67,013.51	11.1
Appliances	38,563.15	13.6	48,232.26	15.0	65,368.15	13.9	57,728.84	9.9	37,434.60	6.2
Fixtures	27,874.49	9.8	42,101.70	13.0	85,982.24	18.3	91,424.52	15.7	96,473.33	16.0
Radios	....	....	....	....	....	....	16,103.52	2.8	114,708.41	19.0
Supplies	148,087.64	52.1	156,557.65	48.5	220,514.92	46.8	287,775.00	49.5	242,881.84	40.2
	$284,074.96	100.0 %	$322,663.50	100.0 %	$470,502.59	100.0 %	$581,619.97	100.0 %	$603,863.54	100.0 %

* Salaries, the largest item, varied widely at the discretion of the president; this explains the low expense in 1928.
† Figure in red.
‡ Principal components: (1) subrentals, properly a credit to rental expense (building owned by company's president), (2) after 1927, intercompany profits.
§ Includes all retail sales to individual consumers, regardless of items.

EXHIBIT 1 (*Continued*)

Item	1926		1927		1928		1929		1930	
Operating Results:										
Total Sales	$627,363.24	100.00 %	$478,183.37‖	100.00 %	$515,840.38‖	100.00 %	$481,806.49‖	100.00 %	$214,039.98‖	100.00 %
Cost of Goods Sold	482,071.14	76.84	378,049.00	79.06	405,060.75	78.52	379,445.47	78.75	169,136.74	79.02
Gross Margin	$145,292.10	23.16 %	$100,134.37	20.94 %	$110,779.63	21.48 %	$102,361.02	21.25 %	$ 44,903.24	20.98 %
Total Expense*	143,409.06	22.86	107,841.53	22.55	92,553.60	17.94	116,895.06	24.27	77,780.53	36.34
Net Profit	$ 1,883.04	0.30 %	$ 7,707.16†	1.61 %†	$ 18,226.03	3.54 %	$ 14,534.04†	3.02 %†	$ 32,877.29†	15.36 %†
Other Income‡	12,567.01	2.00	11,957.18	2.50	10,123.48	1.96	34,102.67	7.08	14,347.79	6.70
Net Gain	$ 14,450.05	2.30 %	$ 4,250.02	0.89 %	$ 28,349.51	5.50 %	$ 19,568.63	4.06 %	$ 18,529.50†	8.66 %†
Sales by Product Groups:										
Retail Sales§	$ 5,907.76	0.9 %	¶	¶						
Repair Sales	32,190.97	5.1								
Contract Sales	58,325.63	9.3								
Appliances	43,482.38	6.9	....	....	$ 53,174.14	10.4 %	$ 44,854.92	9.3 %	$ 40,452.52	18.8 %
Fixtures	99,692.17	15.9	....	....	48,412.18	9.4	38,663.76	8.0	26,024.21	12.2
Radios	202,133.89	32.2	....	....	133,230.92	25.8	80,923.52	16.8	36,347.29	17.0
Supplies	185,630.44	29.7	....	....	143,076.55	27.7	129,975.95	27.0	111,215.96	52.0
Refrigerators	....	....	....	....	137,946.59	26.7	187,388.34	38.9		
	$627,363.24	100.0 %	....	....	$515,840.38	100.0 %	$481,806.49	100.0 %	$214,039.98	100.0 %

* Salaries, the largest item, varied widely at the discretion of the president; this explains the low expense in 1928.

† Figure in red.

‡ Principal components: (1) subrentals, properly a credit to rental expense (building owned by company's president), (2) after 1927, intercompany profits.

§ Includes all retail sales to individual consumers, regardless of items.

‖ Includes sales to Dearborn Company at wholesale selling prices.

¶ No sales breakdown in this year because of confusion in separating the retail business.

EXHIBIT 2

OPERATING RESULTS AND SALES BY PRODUCT GROUPS OF DEARBORN COMPANY RETAIL STORE, 1927–1930

Item	1927		1928		1929		1930	
Operating Results:								
Total Sales	$183,313.33	100.0%	$226,205.69	100.0%	$410,351.35	100.0%	$245,060.05	100.0%
Cost of Goods Sold	122,217.92	66.7	151,455.60	67.0	292,853.52	71.4	171,104.17	69.8
Gross Margin	$ 61,095.41	33.3%	$ 74,750.09	33.0%	$117,497.83	28.6%	$ 73,955.88	30.2%
Total Expense	57,738.77	31.5	74,661.61	33.0	98,864.45	24.0	63,990.16	26.1
Net Operating Profit	$ 3,356.64	1.8%	$ 88.48	0.0%	$ 18,633.38	4.6%	$ 9,965.72	4.1%
Other Income	1,839.74	1.0	2,281.20	1.0	2,559.88	0.6	6,232.74	2.5
Net Gain	$ 5,196.38	2.8%	$ 2,369.68	1.0%	$ 21,193.26	5.2%	$ 16,198.46	6.6%
Sales by Product Groups:								
Repair Sales	$ 40,446.59	22.1%	$ 51,286.52	22.7%	$173,578.62	42.3%	$104,125.98	42.5%
Contract Sales	53,332.20	29.0	35,406.78	15.7	61,552.70	15.0	54,375.67	22.2
Appliances	20,091.36	11.0	7,454.27	3.3	7,386.32	1.8	6,724.90	2.7
Fixtures	64,077.42	35.0	57,090.96	25.1	47,600.76	11.6	30,334.30	12.4
Furniture	....	....	....	....	....	....	6,487.45	2.7
Gifts	....	....	....	....	....	....	6,957.60	2.8
Lamps and Shades	....	....	....	....	....	....	14,577.54	5.9
Radios	1,733.74	0.9	2,895.36	1.3	410.35	0.1	5,013.53	2.0
Refrigerators	....	....	68,264.51	30.2	116,539.78	28.4	13,192.54	5.5
Other	3,632.02	2.0	3,807.29	1.7	3,282.82	0.8	3,270.54	1.3
	$183,313.33	100.0%	$226,205.69	100.0%	$410,351.35	100.0%	$245,060.05	100.0%

company faced competition from specialty wholesale distributors, located outside the area, which sold single items such as radios and washing machines, and from manufacturers who sold direct to industrial users and large retailers. The two wholesale branches and the local wholesaler furnished the most serious competition. The company's officials believed that there was not sufficient electrical supply business in the territory to support four wholesalers.

The customers of the Dearborn Electrical Supply Company were essentially of two types, industrial users and retailers buying for resale. Industrial users included manufacturing plants, public utilities, contracting engineers, and electrical engineers. These customers, with the exception of utilities, bought electrical supplies only. Utilities purchased, in addition, a wide variety of appliances, radios, and refrigerators for resale. The retailers were contractor-dealers, hardware stores, radio stores, specialty stores, department stores, furniture stores, drug stores, grocery stores, and other miscellaneous types, including one florist shop. The company kept no record of sales by types of customers.

Four outside salesmen of the wholesale company made contacts with all types of customers. Two counter salesmen handled telephone orders and over-the-counter sales in the wholesale unit. Three of the outside salesmen operated from the company offices; the fourth lived in his territory. These men were selected on the basis of their general qualifications. All were paid salaries plus expenses, this method being preferred to commission payment because of the large number of items and the wide variations in gross margin. The average salary was $40 a week, and expenses averaged $4 a day. The salesmen traveled in their own cars and were given a mileage allowance. Each man was assigned to a separate territory, in which he handled all the products. The territories varied greatly in size and character; one man, for example, covered only the city in which the company was located. Salesmen were expected to push the sale of certain items which were in season; they were expected, furthermore, to maintain prices, to leave credit decisions to the home office, and to sell only items stocked by the company. They were given complete freedom in routing their work, selecting the number and types of outlets for the company's products, and determining the number and frequency of calls to be made. They averaged individually from

5 to 15 calls a day. They handled selling, put in displays, secured new accounts, and aided in collection work.

During the latter part of 1930 the president had received from company officials a number of suggestions designed to minimize losses of the wholesale company. Included in these suggestions was a proposal to discontinue the wholesale business and concentrate on retailing, since the retail store had shown a profit from the outset. Another proposal was to discontinue the industrial supply business, because sales had shown a steady decline since 1924, and sell only to retail stores and utilities for resale. A third suggestion was to abandon the industrial business and all sales to retailers and utilities except sales of electrical appliances and equipment, such as washing machines, radios, and similar items. If this suggestion were adopted, it would be necessary to add refrigerators and possibly other items of electrical equipment. Thus the firm would become a specialty wholesaler. One executive believed that all these suggested measures were unnecessarily drastic; he was convinced that the addition of a good line of refrigerators would solve the company's difficulties.

The operating results of the Dearborn Electrical Supply Company for a 10-year period and of the Dearborn Company for a 4-year period are shown in Exhibits 1 and 2. The officials of the companies were concerned seriously with the heavy loss experienced in 1930 by the wholesale unit; and because they believed that the business recession might continue indefinitely, they agreed that a thoroughgoing appraisal of objectives and operating results of both companies in the light of past experience was necessary in order to formulate policies which would improve sales and profit prospects.

8. DENNISON MANUFACTURING COMPANY

CHOICE OF METHODS OF PROMOTION BY WAR PRODUCTS DIVISION

Shortly after the entry of the United States into the Second World War, the Dennison Manufacturing Company of Framingham, Massachusetts, added to its organization a war products division to develop sales of specialty paper items required in the production of various types of war materials being purchased by the government.

The Dennison company had been incorporated in 1911 to take over the firm of the same name, founded in 1844. The company had expanded rapidly, until at the end of 1941 it was one of the largest manufacturers of paper products in the country. The company was best known for its high-quality tags, which, from the standpoint of sales volume, constituted the most important of its lines. It produced also a wide variety of boxes, seals, labels, crepe paper, gummed paper, and novelty products. In addition, the company operated one of the largest machine shops in the paper industry, with facilities for printing, laminating, gumming, sewing, die-cutting, creping, flameproofing, and so on.

The company's sales volume for 1941 was $16,543,344, which, except for the years 1927 and 1929, was the largest in the company's history. Dennison products were divided into two main classifications, namely, those sold for resale, known as the "dealer line," and those sold for consumption, known as the "consumer line." These lines were sold by the company's own salesforce to manufacturers, wholesalers, jobbers, and retailers throughout the country. In 1941 the sales organization of the company consisted of a director of sales, an assistant director of sales, 7 regional sales managers, 21 divisional managers, and 150 salesmen. For purposes of sales administration the country was divided into seven regions, with branch offices in Boston, New York, Philadelphia, Chicago, Cleveland, Dallas, and San Francisco. These offices served not only as headquarters for salesmen but also as warehouses for the company's "in-stock" items. Each region was headed by a regional sales manager, and under him were three divisional managers. One divisional manager was in charge of sales of the dealer line; another was in charge of sales of the consumer line; and the third was in charge of service, control, and office routine. Individual salesmen did not sell to all types of accounts but specialized on either the dealer line or the consumer line and were responsible to their respective divisional sales managers in their region.

The Dennison organization was set up in four divisions: production, on the one hand, and merchandise, advertising, and selling on the other. The merchandise division coordinated production and selling and provided for keeping the various lines well balanced in relation to the business as a whole. It did much to harmonize the interests and points of view of the factory and the sales organization. It was responsible for the development of new items and for

the establishment of pricing policies. The merchandise division operated retail stores of its own in each of four large cities in the United States. These stores were not expected to be self-supporting but were maintained for analysis of methods of selling and pricing, for the development of new uses for the company's products, for the introduction and testing of new products, and for other experimental work in merchandising and promotional methods.

At the time the war products division was established, not more than 10% of the total production of the company could be classified as war products; these included principally ammunition boxes and identification tags. About 40% of the production could be classified as essential civilian products; in this classification were production tags, shipping labels, marking tags, sales tax tags, and boxes for the drug and jewelry trades. The remaining 50% of the production was classified as merchandise unessential in a war economy; this group included party decorations, table decorations, favors, display materials, and most of the items that made up the dealer line of the company.

During the First World War the company had failed to secure much war business, partly because its machinery was not well fitted for war products, and partly because the company had been slow to make such conversion as was possible. At the outbreak of the Second World War, circumstances were quite different. The company was already engaged in manufacturing ammunition boxes and identification tags under the lend-lease program. With the entry of the United States into the war, the company immediately established the war products division in order to increase the output and sale of war products. Officers of the Dennison company believed that in less than a year over 90% of the production of the company would be classified as either war products or essential civilian products.

The war products division was set up as a part of the merchandise division, but with more or less complete responsibility for its own products; that is, it developed a line, coordinated production and selling, and assumed the direction of sales work in the field.

At the outset, the war products division consisted of but eight men. Mr. Williams, formerly in charge of the market research division of the Dennison Manufacturing Company, was appointed director of the new division, with headquarters at the plant. Assisting him were seven salesmen, one in each sales region, who

were designated as "war production specialists." It was their task both to find out what paper products were likely to be in demand for war purposes in their regions and to secure orders.

After six weeks of operation, this organization was found to be inadequate from both a merchandising and a selling standpoint. Sales results were disappointing, and the ratio of selling expense was high. The one man in each territory was unable to reach any appreciable number of potential buyers of war products; and since he did not have good leads as to prospective purchasers, many of his calls were unproductive. It was concluded that a larger number of men were needed in the field, both to ferret out merchandising ideas and to make sales. Accordingly, each of the company's 150 salesmen was instructed to devote part of his time to calling on war product contractors. The seven "war production specialists" in the regional offices continued to devote their entire effort to the war products division. At the same time, seven men selected from personnel in the research department and the merchandise division were added to Mr. Williams' staff at Framingham, with responsibility for both the merchandising and the selling of particular groups of war products. It was the task of each of these group managers to furnish all salesmen in the regional offices with a revised list of the firms in their respective areas working on government contracts and to inform them of merchandise ideas that had been developed at the plant and in other sales regions. In turn, each salesman was expected to add to the lists furnished him the names of other firms engaged in war work in his region. He was expected also to report to the plant any new uses of paper for war products that came to his attention.

When it attacked the problem of obtaining a larger volume of war business, the war products division had to determine (1) what type of paper products were used in producing war orders and (2) what firms were purchasing these paper products. Research effort was believed to be needed to supplement the leads furnished by salesmen and by staff representatives at Framingham.

From a government publication the war products division obtained a list of items to be purchased by each of the Army arsenals. These lists were sent to the regional managers of the territories in which the arsenals were located. The regional managers were instructed to visit the arsenals and from the men in charge of production to secure information as to what paper products were

essential to the manufacture of each type of war product. This information was then sent to the home office, where lists were prepared and forwarded to all the salesmen. Thus, if a salesman learned that the government was issuing an invitation to bid on an order for M26 Flares, he would immediately know what paper products would be required to fill the order.

Although this approach to the problem was in the right direction, it was far from a final solution. The war products division found, after a month's trial, that the information which the regional managers gathered from their talks with men in charge of the arsenals was far from specific. The arsenal officials had their own duties to perform; and although they were most courteous in receiving the regional managers, they did not have time to explain in detail the role which paper products played in the manufacture of war materials. Although the information was better than nothing at all, it was too general to be used in planning specific selling efforts. Accordingly the war products division sought a better solution to this problem.

Since the information relating to use of paper products in the production of war materials was to be used in actual sales solicitation, the war products division concluded that sales efforts would be improved if the data were in as accurate and detailed a form as possible. Hence men familiar with blueprint reading were assigned to each arsenal to study the blueprints for the war materials required and to prepare detailed lists of the paper products needed in the manufacture of the war materials. These lists were then forwarded to Framingham, where they were carefully scrutinized by both the war products division and the production division for possible production or pricing problems. When these two divisions were satisfied that the company could deal with all such problems, the lists were approved and compiled into analysis sheets (see Exhibit 1) and forwarded to the salesmen. These sheets enabled the salesmen to approach their prospective customers with knowledge of the specific requirements of current contracts. In fact, the analysis sheets often helped the prospects to solve problems relating to the use of paper in their contracts. Shortly after the adoption of the analysis sheets, the company's sales of war products began to increase, and the war products division concluded that the sheets were definitely helpful in determining the types of paper products needed in war contracts.

EXHIBIT 1

DENNISON MANUFACTURING COMPANY

Analysis Sheet Developed by War Products Division

Defense Item Analysis — NUMBER M26 — ORDNANCE NAME FLARE

DATE 2/25/42
ESTIMATE 50T15981
CUST. 65P19815

	Blueprint No.	Component	Material	Government Specification	Size and Instructions	Thickness	Prices 25 M	50 M	75 M	100 M
1	78-2-253D	Disc	Boxboard with sulphate kraft liner	50-11-79A	OD 9″ × ID ½″ Knife slit from center hole to edge 1 radius	.020	3.85	3.60	3.55	3.50
2	78-2-252D	Disc	" " " "	" " "	OD 9″ × ID 4½″ Knife slit from inside circle to outer edge	.020	3.85	3.60	3.55	3.50
3	78-2-248P	Base Block Assembly	Binder board	Commercial	Dia. 3.755 5/32″ notch on edge	.130–.01	6.55	6.00	5.85	5.75
4	78-2-250K	Upper Disc	Boxboard	"	OD 3.81 × ID 1 1/16″	.020	1.45	1.20	1.10	1.05
5	78-2-250R	Primer Disc	Chip board	"	OD 3.81 × ID .5 5 holes ½″ dia. punched to form circle 2⅛″ dia.	About 1/16″	2.10	1.90	1.85	1.80
6	78-2-253N	Gasket	Cork	23-30	OD 1.71–.01 ID 1.50 + .01	1/16″	4.75	3.75	3.55	3.25
7	78-2-252E	Separator	Onion skin paper	50-11-49A	8½″ × 8½″	.002 –.001	2.75	2.70	2.65	2.60
8	78-2-252F	Cover Parachute	" " "	" " "	10″ × 10″ 1 knife slit 5″ from edge to center	"	4.40	4.10	4.05	4.00
9	78-2-236G2	Closing Disc	" " "	" " "	.197–.005	"	.30	.17	.13	.11
10										

Remarks: These are reorder prices and are f.o.b. Framingham. Prices on items 7, 8, and 9 cover bulk packaging.

Nevertheless, even with the analysis sheets available, sales did not increase so rapidly as the company had anticipated. On investigation, the war products division learned that its method of securing lists of purchasers of paper products for war materials was inadequate. Up to that time the war products division had prepared lists from published sources on contract awards by the government. Firms awarded contracts were listed by regions at the plant, and the lists forwarded to the salesmen in the various regions. These lists were of some value to the salesmen; but after a contract had been awarded, it was often too late for the salesman to obtain an order for paper products from the contractor. By that time the contractor had usually arranged for a source of supply for such materials. Hence, to increase its sales of war products the company had to devise a new method of reaching prospective purchasers.

Although the Dennison company was well known for its regular lines of tags and boxes, it had not established its reputation as a supplier of processed paper for war needs among many companies which were contracting for war materials or were contemplating conversion to war production. Already numerous industries had gone far in their conversion to war production, as was true of the automobile, radio, refrigerator, stove, and chemical industries. Indications in early 1942 were that this conversion would be speeded up and that a substantial number of firms in a wide variety of industries shortly would be working on war contracts. If the Dennison company were effectively to solicit the paper business of these firms, it must make itself known as a capable supplier of processed paper products for war materials, a supplier who could help solve production problems involving paper needs. Then contractors would summon Dennison representatives at the time they were figuring on their materials needs for contracts, and the salesmen could effectively use the analysis sheets supplied by the war products division.

Three methods were considered by the war products division to build a reputation for the Dennison company as a supplier of processed paper products among actual and potential war contractors: (1) salesforce solicitation, (2) industrial and business magazine advertising, and (3) direct-mail advertising.

If the salesforce were to be used to reach a substantial proportion of the prospects, an appreciable part of the time of all 150 salesmen of the organization would be required, and probably new salesmen

would have to be added. Favoring salesforce solicitation was the fact that a salesman usually was highly effective in conveying to business executives the ability of the Dennison company to provide all kinds of processed paper. At the time, however, the company was having difficulty in maintaining its salesforce at full efficiency because some men were being called into military service and others were being attracted to remunerative positions in defense industries. There was a limit also to the degree to which the company was prepared to divert its regular salesforce into solicitation of war contract business. It wished to retain a considerable part of its civilian product business, particularly that for the essential civilian products, in order to hold its position in the industry.

If advertising in industrial magazines were to be used, it was evident that a large number of publications would be needed to attain anything approaching complete coverage of prospects. Certain horizontal media, that is, media cutting across a number of industries, might be employed. Among such magazines were those named below:

The United States Government Advertiser, published weekly, carried notice of all calls for bids on government contracts. Space was sold in any size of 1 inch or more, at the following rates per inch:

1 time	$5.00
7 times	4.50
13 times	4.00
26 times	3.00
52 times	2.00

A page was four columns wide by 13 inches deep. It was believed that this publication was scrutinized closely by executives of firms engaged in or interested in war work.

Army Ordnance, the official organ of the Army Ordnance Association, was published every other month. The rates for this magazine were as follows:

	1 Time	6 Times
1 page	$180	$130
½ page	120	80
¼ page	70	50

A page was approximately 7 by 10 inches. This publication had practically complete circulation among Army ordnance officers

and a limited circulation among business executives interested in Army ordnance problems.

Purchasing had a net paid circulation of approximately 6,000, primarily among purchasing agents. Its rates were as follows:

	1 Time	6 Times	9 Times	12 Times
1 page	$198.00	$186.00	$180.00	$165.00
⅔ page	132.00	128.00	124.00	120.00
½ page	99.00	99.00	96.00	93.00
⅓ page	66.00	66.00	66.00	64.00
¼ page	49.50	49.50	49.50	49.50
⅙ page	33.00	33.00	33.00	33.00

Time was considered because it was believed to be widely read by business executives. Its net paid circulation for the last six months of 1941 was 866,145 copies. Rates for standard units were as follows:

	1 Time	13 Times	26 Times
1 page	$2,725.00	$2,585	$2,450
2 columns	1,925.00	1,825	1,735
1 column	975.00	925	875
½ column	500.00	475	450
Agate line	7.82		

In addition, horizontal business media worthy of consideration included *Factory*, *Buyers' Register*, *Industrial Equipment News*, *Modern Industry*, *Product Engineering*, and *Nation's Business*.

It was not clear to what extent the company could rely on such horizontal media or to what extent these media would reach the executives responsible for specifying and buying paper products for war contracts. In its field work the war products division had directed its salesmen to call on the man in charge of purchasing for war products, who might be either the purchasing agent or an assistant assigned to this task. The management had found that, if the purchasing official was not in a position to buy, he could put the salesman in contact with the production or engineering men who were actively working on war contracts.

In view of the fact that the horizontal media under consideration were not devoted to the problems of particular industries, the war products division believed that it might be necessary, provided

industrial papers were used, also to employ vertical media, especially for those industries heavily engaged in war production. Since a substantial number of industries were already working on war contracts and others were increasingly entering such work, the possible number of publications to be used was large. It included, among others, the automotive, aviation, ceramic, chemical, drug, electrical, construction, refrigeration, stove, marine, radio, and textile industries. In each of the industries to be covered, several magazines were available. The rates charged by these periodicals varied with their circulation but generally ranged from $100 to $300 a page.

The effective use of direct mail depended on the company's ability to build desirable mailing lists. As a result of field selling experience it was thought that mail pieces addressed to purchasing agents for war production material would serve to get the Dennison company listed in the contractors' firms as a supplier of war paper products. A mailing list of firms could be built from the following sources:

1. A list of firms that had received government contract awards. Such a list had been published by the government through October 31, 1941, but not after that date.

2. A list of all ordnance offices and prime contract distributors. This list would be valuable because persons seeking or allotted government contracts visited the nearest ordnance office for advice on contract problems.

3. A list of firms known to be in the process of conversion to the war effort. Such a list would include firms in those industries whose conversion to war production had already been started as a result of orders of the WPB.

4. A list of firms that in the near future would probably be converted to war effort. The accuracy of such a list would depend on the forecasting ability of the members of the war products division.

5. A list of the names secured by the salesforce in its field work.

It was clear that a list of thousands of firms which either were actively engaged in war contracts or were likely to be so engaged in the near future could be built without great expense. It was known that mailing pieces could be sent by third-class mail at a probable cost of 4.5 cents each, including postage, or by first-class mail at 6 cents.

What method or methods of promoting the sale of war product materials should have been adopted?

APPENDICES

APPENDIX A

United States Summary of Retail Trade
Comparison of Stores and Sales: 1929, 1935, and 1939

Kind of Business	Number of Stores			Sales, 1939			
	1929	1935	1939	Amount (000 omitted)	Percentage of Total	Percentage Change from 1929	Percentage Change from 1935
Total, All Stores[1]	1,476,365	1,587,718	1,770,355	$42,041,790	100.0 %	−13 %	+28 %
Food Group	481,891	532,010	560,549	10,164,967	24.2	− 6	+22
Grocery Stores (without fresh meats)	191,876	188,738	200,303	2,225,435	5.3	−35	+ 1
Combination Stores (groceries and meats)	115,549	166,233	187,034	5,496,318	13.1	+41	+32
Dairy Products Stores, Milk Dealers	8,478	16,380	16,834	740,011	1.8	+ 2	+28
Meat Markets, Fish Markets	49,865	39,474	42,360	750,797	1.8	−44	+23
Candy, Nut, Confectionery Stores	63,265	55,197	48,015	295,300	0.7	−48	− 6
Fruit Stores, Vegetable Markets	22,904	32,632	27,666	222,239	0.5	−28	+ 3
Other Food Stores	29,954	33,356	38,337	434,867	1.0	−20	+50
General Stores (with food)	104,089	66,701	39,688	810,342	1.9	−68	−27
General Merchandise Group	54,636	44,651	50,267	5,665,007	13.5	−12	+23
Department Stores	4,221	4,201	4,074	3,974,998	9.5	− 9	+20
Dry Goods and General Merchandise Stores	38,305	28,709	29,247	713,208	1.7	−40	+35
Variety Stores	12,110	11,741	16,946	976,801	2.3	+ 8	+25
Apparel Group	114,296	95,968	106,959	3,258,772	7.8	−23	+23
Men's and Boys' Clothing, Furnishings, Hat Stores	28,197	20,914	21,501	773,312	1.9	−35	+17
Family Clothing Stores	10,551	7,881	10,053	429,454	1.0	−22	+20
Women's Ready-to-Wear Stores	18,253	21,975	25,820	1,009,494	2.4	− 7	+27
Accessories, Other Apparel Stores	33,036	26,231	29,098	429,448	1.0	−29	+30
Shoe Stores (all kinds)	24,259	18,967	20,487	617,064	1.5	−24	+21
Furniture-Household-Radio Group	58,941	45,215	52,827	1,733,257	4.1	−37	+34
Furniture Stores	25,153	17,043	19,902	973,157	2.3	−36	+40
Other Home Furnishings Stores	8,820	9,776	12,012	226,727	0.5	−25	+44
Household Appliance, Radio Dealers	24,968	18,396	20,913	533,373	1.3	−43	+22

Automotive Group	69,379	50,459	60,132	5,548,687	13.2	−21	+31
Motor-Vehicle Dealers (new)	42,204	30,294	33,609	4,810,245	11.4	−23	+29
Used-Car Dealers	3,097	4,751	6,980	193,790	0.4	+38	+59
Accessory, Tire, Battery Dealers	22,313	14,343	18,525	523,685	1.3	−13	+40
Other Automotive	1,765	1,071	1,018	20,967	0.1	−43	+39
Filling Stations	121,513	197,568	241,858	2,822,495	6.7	+58	+43
Lumber-Building Group	52,814	36,553	39,667	1,761,205	4.2	−33	+59
Lumber and Building-Materials Dealers	26,377	21,149	25,067	1,478,459	3.5	−25	+71
Heating, Plumbing, Paint, Electrical Stores	26,437	15,404	14,600	282,746	0.7	−56	+19
Hardware Group	37,572	36,633	39,646	973,709	2.3	−20	+28
Hardware Stores	25,330	26,996	29,147	629,276	1.5	−11	+35
Farm Implement-Tractor-Hardware Dealers	12,242	9,637	10,499	344,433	0.8	−34	+18
Eating Places	134,293	153,468	169,792	2,135,020	5.1	+ 0	+28
Drinking Places	....	98,005	135,594	1,385,032	3.3	....	+91
Drug Stores	58,258	56,697	57,903	1,562,502	3.7	− 8	+27
Liquor Stores (packaged goods)	....	12,105	19,136	586,351	1.4	....	+79
Other Retail Stores	173,618	139,135	172,375	3,496,437	8.3	−28	+34
Fuel, Ice, Fuel-Oil Dealers	19,118	35,293	41,172	1,013,542	2.4	+ 0	+18
Hay, Grain and Feed Stores	21,394	11,132	16,772	623,977	1.5	−37	+80
Farm and Garden Supply Stores	5,740	9,176	4,915	155,312	0.4	+21	−38
Jewelry Stores	19,998	12,447	14,559	361,595	0.8	−33	+54
Cigar Stores, Cigar Stands	33,248	15,350	18,504	207,781	0.5	−49	+14
Florists	9,328	11,242	16,055	148,741	0.3	−16	+51
News Dealers	10,285	7,071	7,407	72,427	0.2	−52	+17
Other Retail Stores	54,507	37,424	52,991	913,062	2.2	−36	+57
Secondhand Stores	15,065	22,550	23,962	138,007	0.3	− 7	+22

[1] Previously published totals for the United States and for the automotive group, for 1929 and 1935, are revised to exclude service garages and other automotive service businesses whose receipts from service sales exceed their sales of merchandise. These are now included in the Census of Service Establishments.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade* (Washington, Government Printing Office, 1941), Vol. I, Part 3, Table 1A, p. 5.

APPENDIX B

UNITED STATES SUMMARY OF RETAIL TRADE: 1939
Part 1. Stores and Sales, by Types of Operation

Type of Operation	Number of Stores[1] 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage Total	1929	1935
Total—All Types	1,770,355	$42,041,790	100.0%	100.0%	100.0%
Independents[2]	1,624,665	31,409,859	74.7	77.6	73.3
Single Store	1,521,145	27,417,200	65.2	68.7	64.9
Multiunit[3]	77,845	3,752,509	8.9	8.8	7.9
Market and Roadside Stands[4]	18,014	103,162	0.3	*	0.3
Leased Departments—Independent	7,661	136,988	0.3	0.1	0.2
Chains[5]	123,195	9,105,825	21.7	20.3	23.3
Local Chains[6]	25,455	1,581,386	3.8	6.7	3.1
Sectional[7] or National Chains	82,049	6,771,009	16.1	12.6	19.5
Manufacturer-Controlled Chains[8]	10,123	583,062	1.4	0.7	0.4
Leased-Department Chains	5,568	170,368	0.4	0.3	0.3
Other Types[9]	22,495	1,526,106	3.6	2.1	3.4
Utility-Operated Stores	4,836	151,539	0.4	0.3	0.4
Direct Selling (house to house)[10]	5,199	153,397	0.4	0.2	0.4
Commissaries or Company Stores	2,007	148,248	0.3	0.3	0.3
Farmer and Consumer Co-operative Stores	3,698	224,375	0.5	0.2	0.3
State Liquor Stores	2,618	249,430	0.6	....	0.5
Mail-Order Houses[11]	434	537,413	1.3	1.0	1.3
Other Types of Operation	3,703	61,704	0.1	0.1	0.2

[1] Number of retail establishments.
[2] Three or fewer stores under one management-ownership.
[3] Two- or three-store organizations; and local branch systems, such as found in the furniture and department store fields.
[4] Not including roadside stands at which the farmer sells his own produce.
[5] Four or more units.
[6] Substantially all units in and around a single city.
[7] Stores in different cities in the same state or in a single section of the country.
[8] Stores distributing the products of a manufacturer or a group of manufacturers who are joint owners.
[9] Sub-group considered as major basis of classification. For instance, utility-operated stores are classified as such, regardless of other characteristics.
[10] Central offices or multiunit headquarters of crews of canvassers.
[11] Not including retail stores operated by mail-order concerns.
* Less than 1/10 of 1%.
Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade*, "Types of Operation" (Washington, Government Printing Office, 1941), Table 3A, p. 5.

United States Summary of Retail Trade: 1939 (*Continued*)
Part 2. Stores and Sales, by Kinds of Business and Types of Operation

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939 Amount (000 omitted)	Sales: 1939 Percentage of Total	Percentage of Total Sales 1929	Percentage of Total Sales 1935
Grocery Stores (without fresh meats)	200,303	$2,225,435	100.0%	100.0%	100.0%
Independents	179,335	1,491,473	67.0	53.6	61.3
Chains	20,093	720,427	32.4	45.7	38.3
Direct Selling (house to house)	263	3,456	0.2		0.2
Commissaries or Company Stores	307	4,597	0.2	0.7	0.1
Other Types	305	5,482	0.2		0.1
Combination Stores (groceries-meats)	187,034	5,496,318	100.0	100.0	100.0
Independents	166,276	3,366,153	61.3	67.6	60.7
Chains	20,257	2,112,092	38.4	32.2	39.1
Commissaries or Company Stores	166	6,557	0.1	0.2	0.1
Other Types	335	11,516	0.2		0.1
Dairy Products, Milk Dealers	16,834	740,011	100.0	*	*
Independents	13,603	418,408	56.5		
Chains	3,076	306,028	41.4		
Other Types	155	15,575	2.1		
Candy, Nut, Confectionery Stores	48,015	295,300	100.0	*	100.0
Independents	45,579	242,183	82.0	....	84.2
Chains	2,223	51,043	17.3	....	13.8
Other Types	213	2,074	0.7	....	2.0
Department Stores	4,074	3,974,998	100.0	100.0	100.0
Independents	1,371	2,312,279	58.2	72.1	61.4
Chains	2,672	1,194,517	30.0	16.7	26.7
Mail-Order Houses	24	464,289	11.7	11.2	11.7
Other Types	7	3,913	0.1		0.2
Variety Stores	16,946	976,801	100.0	100.0	100.0
Independents	10,555	128,909	13.2	9.8	9.2
Chains	6,372	847,686	86.8	90.1	90.8
Other Types	19	206	†	0.1	†
Men's-Boys' Clothing, Furnishings, Hat Stores	21,501	773,312	100.0	100.0	100.0
Independents	19,621	598,737	77.4	77.9	78.2
Chains	1,816	171,579	22.2	21.2	21.2
Other Types	64	2,996	0.4	0.9	0.6
Family Clothing Store	10,053	429,454	100.0	100.0	100.0
Independents	8,935	352,639	82.1	71.5	79.0
Chains	1,082	532	17.8	27.3	20.9
Other Types	36	76,283	0.1	1.2	0.1

* Comparable data not available.
† Less than 1/10 of 1%.

UNITED STATES SUMMARY OF RETAIL TRADE: 1939 (*Continued*)

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939 Amount (000 omitted)	Sales: 1939 Percentage of Total	Percentage of Total Sales 1929	Percentage of Total Sales 1935
Women's Ready-to-Wear Stores	25,820	$1,009,494	100.0%	100.0%	100.0%
Independents	22,424	694,119	68.8	74.3	72.3
Chains	2,880	263,102	26.1	22.7	25.2
Leased Departments	386	31,705	3.1	3.0	1.7
Other Types	130	20,568	2.0		0.8
Shoe Stores (all kinds)	20,487	617,064	100.0	100.0	100.0
Independents	13,215	253,822	41.2	53.5	43.4
Chains	5,721	306,816	49.7	38.0	50.0
Leased Departments	1,522	52,549	8.5	8.5	6.3
Other Types	29	3,877	0.6		0.3
Furniture Stores	19,902	973,157	100.0	100.0	100.0
Independents	19,091	829,830	85.3	83.9	86.0
Chains	784	141,864	14.6	14.2	13.5
Other Types	27	1,463	0.1	1.9	0.5
Household Appliance Dealers	11,095	294,518	100.0	*	*
Independents	5,007	92,436	31.4		
Chains	1,214	53,973	18.3		
Leased Departments	252	5,147	1.7		
Utility-Operated Stores	4,449	138,635	47.1		
Direct Selling (house to house)	162	4,028	1.4		
Other Types	11	299	0.1		
Radio-Household Appliance Dealers	6,907	190,180	100.0	*	*
Independents	6,529	160,020	84.1		
Chains	169	19,392	10.2		
Leased Departments	49	1,514	0.8		
Utility-Operated Stores	123	7,436	3.9		
Direct Selling (house to house)	29	332	0.2		
Other Types	8	1,486	0.8		
Radio Stores—Other	2,911	48,675	100.0	100.0	100.0
Independents	2,831	39,122	80.4	79.0	75.8
Chains	70	9,292	19.1	19.1	23.1
Other Types	10	261	0.5	1.9	1.1
Motor-Vehicle Dealers (new)	33,609	4,810,245	100.0	*	100.0
Independents	33,272	4,679,450	97.3	....	95.6
Chains	327	129,789	2.7	....	4.4
Other Types	10	1,006	†	....	†
Accessory, Tire, Battery Dealers	18,525	523,685	100.0	*	100.0
Independents	14,500	287,519	54.9	....	50.0
Chains	4,017	235,961	45.1	....	50.0
Other Types	8	205	†	....	†

* Comparable data not available.
† Less than 1/10 of 1 %.

United States Summary of Retail Trade: 1939 (*Continued*)

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939 Amount (000 omitted)	Sales: 1939 Percentage of Total	Percentage of Total Sales 1929	Percentage of Total Sales 1935
Filling Stations	241,858	$2,822,495	100.0%	100.0%	100.0%
Independents	230,460	2,495,741	88.4	66.0	77.9
Chains	10,291	288,370	10.2	33.8	21.5
Cooperatives	1,017	35,304	1.3	0.2	0.5
Other Types	90	3,080	0.1		0.1
Lumber, Building-Material Dealers	25,067	1,478,459	100.0	*	100.0
Independents	19,181	1,177,407	79.6	....	75.6
Chains	5,781	295,582	20.0	....	23.9
Other Types	105	5,470	0.4	....	0.5
Paint, Glass, Wallpaper Stores	8,480	152,673	100.0	*	100.0
Independents	7,427	111,269	72.9	....	76.7
Chains	1,039	40,586	26.6	....	23.0
Other Types	14	818	0.5	....	0.3
Hardware Stores	29,147	629,276	100.0	100.0	100.0
Independents	28,641	600,921	95.5	94.6	96.1
Chains	444	25,413	4.0	3.0	3.9
Other Types	62	2,942	0.5	2.4	†
Restaurants, Other Eating Places	169,792	2,135,020	100.0	100.0	100.0
Independents	164,401	1,830,039	85.7	86.1	84.8
Chains	5,087	297,440	13.9	13.6	14.8
Other Types	304	7,541	0.4	0.3	0.4
Drug Stores with Fountain	39,452	1,205,241	100.0	*	100.0
Independents	36,191	877,695	72.8	....	71.2
Chains	3,240	326,549	27.1	....	28.8
Other Types	21	997	0.1	....	†
Drug Stores, Other	18,451	357,261	100.0	*	100.0
Independents	17,532	282,825	79.2	....	84.3
Chains	885	73,713	20.6	....	15.5
Other Types	34	723	0.2	....	0.2
Liquor Stores (packaged goods)	19,136	586,351	100.0	—	100.0
Independents	15,889	316,899	54.1	—	48.2
Chains	621	19,875	3.4	—	1.8
State Liquor Stores	2,618	249,430	42.5	—	49.8
Other Types	8	147	†	—	0.2
Fuel, Ice, Fuel Oil Dealers	41,172	1,013,542	100.0	100.0	100.0
Independents	39,763	857,333	84.6	80.1	82.8
Chains	1,134	152,681	15.1	18.3	16.5
Other Types	275	3,528	0.3	1.6	0.7

* Comparable data not available.
† Less than 1/10 of 1%.

UNITED STATES SUMMARY OF RETAIL TRADE: 1939 (*Continued*)

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939 Amount (000 omitted)	Sales: 1939 Percentage of Total	Percentage of Total Sales 1929	Percentage of Total Sales 1935
Hay, Grain and Feed Stores	16,772	$ 623,977	100.0%	*	100.0%
Independents	14,379	445,538	71.5	....	71.6
Chains	1,233	74,442	11.9	....	16.0
Cooperatives	1,144	103,729	16.6	....	11.7
Other Types	16	268	†	....	0.7
Farm and Garden Supply Stores	4,915	155,312	100.0	*	100.0
Independents	4,384	106,676	68.7	....	75.1
Chains	121	12,535	8.1	....	4.7
Cooperatives	331	25,583	16.5	....	17.8
Mail-Order	36	8,251	5.3	....	1.7
Other Types	43	2,267	1.4	....	0.7
Jewelry Stores	14,559	361,595	100.0	100.0%	100.0
Independents	13,993	321,746	89.0	93.0	90.4
Chains	540	38,014	10.5	6.4	9.4
Other Types	26	1,835	0.5	0.6	0.2
Cigar Stores, Cigar Stands	18,504	207,781	100.0	100.0	100.0
Independents	16,886	150,060	72.2	73.5	61.9
Chains	1,533	56,300	27.1	25.1	35.8
Other Types	85	1,421	0.7	1.4	2.3
Florists	16,055	148,741	100.0	*	100.0
Independents	15,933	144,109	96.9	....	96.5
Chains	102	4,558	3.1	....	3.5
Other Types	20	74	†	....	†
News Dealers	7,407	72,427	100.0	*	100.0
Independents	6,051	52,501	72.5	....	68.7
Chains	1,342	19,766	27.3	....	30.7
Other Types	14	160	0.2	....	0.6
All Other Kinds of Business	455,572	6,712,992	100.0	100.0	100.0

* Comparable data not available.
† Less than 1/10 of 1%.
Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade,* "Types of Operation" (Washington, Government Printing Office, 1941), Table 3A, pp. 5–6.

APPENDIX C

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939
Part 1. Number of Establishments, Sales, and Operating Expenses, by Types of Operation

Type of Operation	Number of Establishments[1]	Sales[2] (000 omitted)	Operating Expenses[3] Amount (000 omitted)	Operating Expenses[3] Percentage of Sales
Total—All Types	200,573	$55,265,640	$5,518,456	10.0 %
Service and Limited-Function Wholesalers	101,627	23,641,924	3,023,627	12.8
Wholesale Merchants	91,323	18,688,897	2,540,959	13.6
Voluntary Group Wholesalers	703	753,586	85,586	11.4
Converters (textile)	631	425,167	41,152	9.7
Export Merchants	586	778,001	59,537	7.7
Importers	2,158	1,379,575	114,418	8.3
Industrial Distributors	1,471	729,650	121,687	16.7
Cash-and-Carry Wholesalers	1,198	108,902	5,994	5.5
Drop Shippers or Desk Jobbers	937	474,891	30,380	6.4
Wagon Distributors	2,398	80,259	9,813	12.2
Retailer-Cooperative Warehouses	222	222,996	14,101	6.3
Manufacturers' Sales Branches (with stocks)	12,977	8,846,940	1,191,188	13.5
Manufacturers' Sales Offices (without stocks)	5,119	4,679,262	324,175	6.9
Petroleum Bulk Stations and Terminals	30,825	3,807,908	420,646	11.0
Independent Bulk Stations	6,357	627,674	76,126	12.1
Commission Stations	17,530	1,080,479	108,084	10.0
Salary Stations	6,053	1,739,676	205,199	11.8
Cooperative Bulk Stations	665	37,962	5,057	13.3
Distributing Terminals	220	322,117	26,180	8.1
Agents and Brokers	20,903	11,201,035	307,752	2.7
Auction Companies	649	434,283	14,062	3.2
Brokers (merchandise)	4,710	3,390,695	51,327	1.5
Commission Merchants	2,758	2,748,072	69,163	2.5
Export Agents	654	571,449	16,591	2.9
Import Agents	394	343,105	6,698	2.0
Manufacturers' Agents (with stocks)	1,907	252,056	29,372	11.7
Manufacturers' Agents (without stocks)	7,871	1,144,961	46,138	4.0
Selling Agents	1,487	1,741,777	64,132	3.7
Other Agents	473	574,637	10,269	1.8
Assemblers (mainly farm products)	29,122	3,088,571	251,068	8.1
Assemblers of Farm Products	9,866	792,159	50,432	6.4
Commission Buyers	1,523	121,704	3,941	3.2
Cooperative Marketing Associations	2,583	611,029	70,048	11.5
Cooperative Sales Agencies	191	578,939	17,572	3.0
Cream Stations	3,870	48,564	3,901	8.0
Country Grain Elevators—Independent	3,180	271,154	15,975	5.9
Country Grain Elevators—Line	4,061	226,917	15,877	7.0
Country Grain Elevators—Cooperative	1,843	196,430	10,828	5.5
Packers and Shippers	2,005	241,675	62,494	25.9

[1] Number of places of business.
[2] Total receipts, excluding returns by customers or allowances to customers, but including sales taxes.
[3] Not including withdrawals by proprietor-owners of unincorporated businesses, and not including imputed interest on investment.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Wholesale Trade,* "Business-Size Groups and An Analysis of Operating Expenses" (Washington, Government Printing Office, 1941), Table 1, p. 8.

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939 (*Continued*)
Part 2. Number of Establishments, Sales, and Operating Expenses of Wholesale Merchants and Industrial Distributors, by Kinds of Business

Kind of Business	Number of Establishments[1]	Sales[2] (000 omitted)	Operating Expenses[3] Amount (000 omitted)	Operating Expenses[3] Percentage of Sales
Wholesale Merchants and Industrial Distributors[4]	92,794	$19,418,547	$2,662,646	13.7 %
Amusement and Sporting Goods	1,255	135,765	26,558	19.6
Bicycles and Supplies	40	5,005	899	18.0
Cameras and Photographic Supplies	105	12,356	2,404	19.5
Motion-Picture Equipment and Supplies (except films)	64	9,950	1,511	15.2
Motion-Picture Film Exchanges	203	22,269	4,272	19.2
Sporting Goods	224	36,720	6,786	18.5
Toys, Novelties, and Fireworks	481	37,950	8,080	21.3
All Other	138	11,515	2,606	22.6
Automotive	7,912	1,954,834	214,821	11.0
Automobiles (new and used)	567	1,300,976	65,253	5.0
Trucks and Tractors	577	66,296	11,639	17.6
Automotive Accessories and Equipment	2,827	257,123	59,971	23.3
Automotive Parts	3,310	253,482	66,763	26.3
Tires and Tubes	631	76,957	11,195	14.5
Beer, Wines, and Liquors	5,986	1,171,509	150,605	12.9
Beer and Ale	4,652	491,557	76,104	15.5
Wines and Liquors	1,334	679,952	74,501	11.0
Chemicals and Paints	1,593	216,696	40,175	18.5
Dyestuffs	57	20,601	3,190	15.5
Explosives	49	2,824	400	14.2
Industrial Chemicals	259	80,704	11,078	13.7
Naval Stores	23	11,528	1,088	9.4
Paints and Varnishes	608	46,293	10,859	23.5
Paints with Glass and/or Wallpaper	311	28,675	7,907	27.6
All Other	286	26,071	5,653	21.7
Clothing and Furnishings	4,024	668,423	96,493	14.4
Clothing and Furnishings (general line)	422	61,129	8,896	14.6
Men's and Boys'	1,155	150,644	21,262	14.1
Women's and Children's	1,056	216,766	33,620	15.5
Furs, Dressed, and Fur Clothing	488	61,518	7,486	12.2
Millinery and Millinery Supplies	450	62,184	10,391	16.7
Shoes and Other Footwear	453	116,182	14,838	12.8
Coal and Coke	520	270,338	27,728	10.3
Drugs (general line)	259	323,863	43,340	13.4
Service Wholesalers (without liquor)	214	251,534	33,369	13.3
Service Wholesalers (with liquor)	45	72,329	9,971	13.8
Drugs and Drug Sundries (specialty line)	1,242	147,953	38,519	26.0
Proprietary Medicines	391	42,176	8,066	19.1
Toiletries	367	45,392	17,278	38.1
Drug Specialties and Sundries	484	60,385	13,175	21.8
Dry goods (general line)	217	204,037	30,945	15.2
Dry Goods (specialty lines)	2,911	479,593	62,984	13.1
Hosiery and Lingerie	404	84,461	9,174	10.9
Notions	861	92,549	17,704	19.1
Piece Goods:				
General Line	46	13,769	2,094	15.2
Cotton	282	54,752	6,329	11.6
Silks, Linen, Rayon, and Velvet	366	78,148	7,812	10.0
Woolen and Worsted	348	89,046	9,631	10.8
Other	309	37,212	5,574	15.0
Other Dry Goods Specialties	295	29,656	4,666	15.7

United States Summary of Wholesale Trade: 1939 (*Continued*)

Kind of Business	Number of Establishments[1]	Sales[2] (000 omitted)	Operating Expenses[3]	
			Amount (000 omitted)	Percentage of Sales
Electrical Goods	3,036	$ 777,874	$129,223	16.6 %
Electrical Merchandise (general line)	452	294,966	39,489	13.4
Apparatus and Equipment	205	23,401	5,379	23.0
Wiring Supplies and Construction Materials	942	124,991	21,899	17.5
Radios and Equipment	658	111,278	21,178	19.0
Refrigerators and Equipment (household)	159	118,018	20,116	17.0
All other	620	105,220	21,162	20.1
Farm Products—Raw Materials	1,764	1,113,431	78,662	7.1
Cotton	133	181,956	12,577	6.9
Grains	373	452,464	24,120	5.3
Hides, Skins, and Raw Furs	609	158,206	12,779	8.1
Horses and Mules	26	6,992	329	4.7
Livestock	105	8,253	1,041	12.6
Tobacco (leaf)	144	62,189	9,124	14.7
Wool and Mohair	153	179,634	11,876	6.6
All Other	221	63,737	6,816	10.7
Farm Products—Consumer Goods	10,072	2,003,035	267,302	13.3
Dairy Products	1,977	465,744	108,347	23.3
Dairy and Poultry Products	725	240,254	20,762	8.6
Poultry and Poultry Products	1,527	238,693	21,974	9.2
Fruits and Vegetables (fresh)	5,037	971,052	106,316	10.9
Fresh Fruits Only	776	81,964	9,329	11.4
All Other	30	5,328	574	10.8
Farm Supplies	1,424	305,451	40,831	13.4
Feed	762	126,788	13,926	11.0
Fertilizer	80	14,762	1,606	10.9
Seeds	407	100,348	19,081	19.0
All Other	175	63,553	6,218	9.8
Furniture and House Furnishings	1,920	319,289	53,413	16.7
China, Glassware, and Crockery	236	20,654	4,706	22.8
Floor Coverings	411	133,462	18,239	13.7
Furniture (general line)	48	10,432	2,188	21.0
Furniture (household)	319	45,510	9,590	21.1
Furniture (office)	50	3,044	523	17.2
House Furnishings (except as specified)	741	88,568	13,706	15.5
Musical Instruments and Sheet Music	115	17,619	4,461	25.3
Groceries (general line)	2,748	1,302,579	125,321	9.6
Not Sponsoring Voluntary or Cooperative Groups	2,748	1,302,579	125,321	9.6
Groceries and Foods (specialty lines)	10,205	1,568,483	231,239	14.7
Breakfast Cereals	32	21,984	9,644	43.9
Canned Foods	350	77,353	9,201	11.9
Coffee, Tea, and Spices	589	78,956	20,574	26.1
Coffee Roasting and Spice Grinding	275	105,794	19,885	18.8
Confectionery	1,675	122,587	16,574	13.5
Fish and Sea Foods	1,104	126,640	25,584	20.2
Flour	315	44,385	5,140	11.6
Fruits and Vegetables (frosted)	28	8,318	800	9.6
Meats and Provisions	2,340	510,276	56,505	11.1
Other Food and Grocery Specialties	3,497	472,190	67,332	14.3
Hardware	1,308	568,101	105,142	18.5
General Line (with industrial department)	402	377,774	68,959	18.3
General Line (without industrial department)	355	139,556	24,963	17.9
Specialty Lines	551	50,771	11,220	22.1
Jewelry	1,571	199,831	36,263	18.1
Jewelry (general line)	194	62,071	10,635	17.1
Clocks and Watches	140	38,503	7,156	18.6
Diamonds and Other Precious Stones	302	26,030	2,694	10.3
All Other	935	73,227	15,778	21.5

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939 (*Continued*)

Kind of Business	Number of Establishments[1]	Sales[2] (000 omitted)	Operating Expenses[3]	
			Amount (000 omitted)	Percentage of Sales
Lumber and Construction Materials	2,810	$ 593,211	$106,158	17.9%
Builders' Supplies (general line)	183	63,427	10,532	16.6
Lumber	836	194,664	27,838	14.3
Lumber and Millwork	127	35,598	6,283	17.6
Millwork	266	57,491	12,783	22.2
Brick, Tile, and Terra Cotta	132	16,898	2,717	16.1
Cement, Lime, and Plaster	98	21,048	3,361	16.0
Glass	280	31,927	9,395	29.4
All Other	888	172,158	33,249	19.3
Machinery—Equipment—Supplies	9,580	1,230,010	251,886	20.5
Commercial Equipment and Supplies:				
Office Machines and Equipment	212	17,201	4,999	29.1
Restaurant and Hotel Supply Houses	434	47,658	11,252	23.6
Garage and Filling Station Equipment	169	9,877	2,537	25.7
Soda Fountain Equipment and Supplies	29	1,846	431	23.3
Store Machines	46	2,900	476	16.4
Store Fixtures and Equipment	398	20,626	5,500	26.7
All Other	339	30,366	6,473	21.3
Farm and Dairy:				
Dairy Equipment	106	19,479	3,562	18.3
Farm Implements	20	2,944	643	21.8
Farm Machinery and Equipment	183	34,325	5,393	15.7
Industrial Machinery, Equipment, and Supplies:				
Industrial (general line)	116	70,267	13,230	18.8
Belting, Hose, and Packing	211	18,837	4,576	24.3
Construction (except road building)	152	23,745	5,394	22.7
Road Building	251	72,613	14,003	19.3
Machine Tools	124	26,413	4,286	16.2
Mine and Mill Supplies	412	99,659	19,083	19.1
Oil Well Supply Houses	895	179,059	18,757	10.5
Power Plant and Power Transmission	88	10,399	1,989	19.1
Printing and Lithographing (except paper)	151	10,909	3,494	32.0
Rope, Cordage, and Twine	53	12,717	1,804	14.2
Textile	74	8,387	1,912	22.8
Used Machinery and Equipment	286	15,163	4,107	27.1
All Other	1,539	171,984	35,399	20.6
Professional Equipment and Supplies:				
Dental Supply Houses	328	33,732	9,655	28.6
Religious Supply Houses	92	8,308	2,278	27.4
School Equipment and Supplies	134	21,324	5,408	25.4
Surgical, Medical, and Hospital	368	50,254	13,225	26.3
All Other	110	13,427	3,276	24.4
Service Equipment and Supplies:				
Barber and Beauty Supply Houses	853	44,543	14,479	32.5
Laundry and Dry Cleaning	203	34,963	7,228	20.7
Tailors' Supplies	64	2,809	565	20.1
Undertakers' Supplies	107	4,545	1,277	28.1
Upholsterers' Supplies	199	26,146	6,015	23.0
All Other	597	34,482	8,236	23.9
Transportation Equipment and Supplies:				
Railroad	64	24,015	5,894	24.5
Marine	149	21,020	4,284	20.4
Other	24	3,068	766	25.0
Metals and Metal Work (except scrap)	972	429,819	56,243	13.1
Building Metal Work	133	13,164	2,699	20.5
Iron and Steel Products (general line)	92	75,628	14,721	19.5
Iron and Steel Products (semifinished)	56	11,387	2,432	21.4
Iron and Steel Products (flat)	193	64,495	13,020	20.2
Wire and Wire Products	60	5,915	1,359	23.0
Iron and Steel Finished Products (N.E.C.)	283	53,709	11,437	21.3
Copper	37	49,250	2,043	4.1
All Other	118	156,271	8,532	5.5

United States Summary of Wholesale Trade: 1939 (*Continued*)

Kind of Business	Number of Establishments[1]	Sales[2] (000 omitted)	Operating Expenses[3] Amount (000 omitted)	Operating Expenses[3] Percentage of Sales
Paper and Its Products	2,851	$ 541,302	$ 97,368	18.0 %
Wrapping or Coarse Paper and Products	1,656	291,926	50,853	17.4
Printing and Writing Paper	416	183,438	28,931	15.8
Stationery and Stationery Supplies	503	45,588	10,871	23.8
Wallpaper	276	20,350	6,713	33.0
Petroleum and Its Products	886	158,322	21,950	13.9
Plumbing and Heating Equipment and Supplies	2,204	374,806	69,382	18.5
Plumbing and Heating (general line)	675	185,102	32,118	17.4
Heating (including stoves and ranges)	361	35,880	8,533	23.8
Plumbing Fixtures, Equipment, and Supplies	916	129,282	22,878	17.7
All Other	252	24,542	5,853	23.8
Tobacco and Products (except leaf)	2,390	1,066,923	52,660	4.9
Waste Materials	6,007	615,495	93,541	15.2
Iron and Steel Scrap	1,851	298,252	40,036	13.4
Junk and Scrap (general line)	1,888	92,876	17,231	18.6
Waste Paper, Rags, and Rubber	1,118	132,686	24,794	18.7
Nonferrous Metals	389	49,073	5,126	10.4
All Other	761	42,608	6,354	14.9
All Other Products	5,127	677,574	113,894	16.8
Books, Periodicals, and Newspapers	856	166,848	30,412	18.2
Flowers and Nursery Stock	716	42,078	8,473	20.1
Forest Products (except lumber)	554	42,404	8,141	19.2
General Merchandise	106	61,551	9,381	15.2
Leather and Shoe Findings	934	112,748	14,515	12.9
Leather Goods	137	12,691	2,511	19.8
Oils and Greases (animal and vegetable)	64	41,416	3,520	8.5
Optical Goods	565	41,530	14,936	36.0
Textiles and Materials (other than dry goods)	286	32,831	5,115	15.6
Yarns	157	65,134	5,437	8.3
Miscellaneous Kinds of Business	752	58,343	11,453	19.6

[1] Number of places of business.
[2] Total receipts, excluding returns by customers or allowances to customers, but including sales taxes.
[3] Not including withdrawals by proprietor-owners of unincorporated businesses and not including imputed interest on investment.
[4] Industrial distributors are distinguished from wholesale merchants by the fact that they sell primarily to industrial users rather than to retailers. The classification of wholesale merchants and industrial distributors by kinds of business cannot be readily reconciled with the classification in Part 1 according to types of operation. Many concerns are engaged both in wholesale business and in industrial business. From a marketing standpoint, the classification "Industrial Distributors" would normally be broader than that used by the Census.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Wholesale Trade*, "Business-Size Groups and An Analysis of Operating Expenses" (Washington, Government Printing Office, 1941), Table 1, pp. 8–10.

APPENDIX D

Operating Figures for Department Stores, by Sales Volume: 1941

(Net Sales = 100%, except as otherwise noted)

Items	Net Sales (in thousands)									
	Less than $150	$150–300	$300–500	$500–750	$750–1,000	$1,000–2,000	$2,000–4,000	$4,000–10,000	$10,000–20,000	$20,000 or more
Number of Reports[1]	39	36	42	33	33	58	54	63	30	19
Aggregate Sales (in thousands)	$4,163	$7,531	$15,653	$18,940	$52,298	$74,348	$137,479	$407,544	$411,189	$655,876
Typical Net Sales (in thousands)	$85	$200	$350	$575	$765	$1,250	$2,500	$6,000	$ 13,500	$ 27,700
Change in Sales (1941/1940)	114.0	116.0	117.0	120.0	118.0	118.0	118.0	119.0	118.0	115.8
Average Gross Sale	*	*	*	*	*	$2.20	$2.31	$2.33	$2.48	$3.07
Returns and Allowances:										
Percentage of Gross Sales	*	*	*	4.95 %†	6.55 %†	7.25 %†	7.0 %	9.1 %	10.3 %	12.15 %
Percentage of Net Sales	*	*	*	5.2†	7.0†	7.8†	7.5	10.0	11.5	13.8
Initial Markup (percentage of original retail value) on Invoice Cost Delivered[2]	*	*	37.05 %	38.25 %	38.4 %	38.2 %	39.05 %	39.55 %	39.3 %	39.4 %
Markdowns	*	*	6.3 %†	4.9 %†	5.4 %†	4.35 %†	4.6 %†	4.55 %	4.35 %	4.2 %
Discounts to Employees and Others	*	*	0.5†	0.6†	0.45†	0.55†	0.55†	0.6	0.8	0.7
Stock Shortages	*	*	1.1†	0.8†	0.95†	0.8	0.65	0.75	0.95	0.85
Total Retail Reductions	*	*	7.9 %†	6.3 %	6.8 %†	5.7 %	5.8 %	5.9 %	6.1 %	5.75 %
Inward Freight, Express, and Truckage	1.35 %	1.25 %	1.35 %	1.05 %	1.1 %	1.0 %	1.15 %	0.95 %	0.85 %	0.6 %
Alteration and Workroom Costs, Net	0.2†	0.4†	0.35†	0.3	0.3	0.4	0.5	0.65	0.6	0.7
Cash Discounts Received on Purchases (percentage of sales)	2.6	2.65	2.75	2.75	3.0	2.75	2.7	3.05	3.2	3.5
Gross Margin	31.6 %	33.3 %	34.5 %	36.8 %	36.9 %	37.0 %	37.7 %	38.4 %	38.2 %	38.7 %
Total Expense	30.0	30.8	30.9	33.0	32.4	33.2	33.1	34.0	35.1	34.7
Net Profit or Loss	1.6 %	2.5 %	3.6 %	3.8 %	4.5 %	3.8 %	4.6 %	4.4 %	3.1 %	4.0 %
Net Other Income (including interest on capital owned)	2.4	2.5	2.9	2.5	2.5	3.2	2.9	3.2	3.6	3.6
Net Gain before Federal Tax on Income:										
Percentage of Net Sales	4.0 %	5.0 %	6.5 %	6.3 %	7.0 %	7.0 %	7.5 %	7.6 %	6.7 %	7.6 %
Percentage of Net Worth	9.5	13.0	16.5	18.0	20.0	17.6	19.0	20.0†	16.0†	16.7†

Expenses:										
Total Pay Roll	16.5 %	15.9 %	16.5 %	17.2 %	16.45 %	17.35 %	16.5 %	16.6 %	17.85 %	17.7 %
Real Estate Costs[3]	3.5	3.4	2.95	3.45	3.7	3.45	3.9	4.0	3.8	4.2
Newspaper Advertising	*	*	1.75†	2.1†	2.3	2.55	2.65	2.9	2.95	2.55
Direct Advertising	*	*	0.15†	0.15†	0.15†	0.15†	0.15	0.2	0.2	0.2
Other Advertising	*	*	0.4†	0.25†	0.25	0.25	0.2	0.25	0.2	0.25
Total Advertising (subtotal)	1.5	2.35	(2.3)	(2.5)	(2.7)	(2.95)	(3.0)	(3.35)	(3.35)	(3.0)
Taxes[4]	1.1	1.0	1.0	1.15	1.2	1.05	1.15	1.15	1.25	1.25
Interest[5]	2.5	2.25	2.15	2.0	1.9	1.9	1.95	1.95	1.8	1.75
Supplies	1.05	1.3	1.4	1.6	1.7	1.7	1.75	1.85	1.9	1.8
Service Purchased	1.05	1.15	1.0	1.0	1.0	1.15	1.05	1.15	1.35	1.25
Losses from Bad Debts	0.2†	0.2	0.45	0.35	0.2	0.25	0.2	0.2	0.2	0.2
Other Unclassified	0.65†	0.85†	0.7	0.85	0.7	0.75	0.9	1.0	0.9	1.15
Traveling	0.3†	0.3	0.35	0.35	0.45	0.35	0.35	0.35	0.3	0.2
Communication	0.45	0.5	0.5	0.5	0.45	0.45	0.45	0.5	0.5	0.5
Repairs	0.15†	0.25	0.35	0.55	0.45	0.5	0.55	0.6	0.55	0.5
Insurance[5]	0.5	0.5	0.4	0.4	0.35	0.35	0.3	0.25	0.2	0.15
Depreciation[5]	0.35	0.55	0.55	0.65	0.65	0.55	0.6	0.55	0.7	0.6
Professional Services[6]	0.2†	0.3	0.3	0.45	0.5	0.45	0.45	0.5	0.45	0.45
Total Expense	30.0 %	30.8 %	30.9 %	33.0 %	32.4 %	33.2 %	33.1 %	34.0 %	35.1 %	34.7 %
Rate of Stock-turn (times a year):										
Based on Beginning and Ending Inventories	2.35	3.0	3.3	3.9	4.25	4.3	4.5	4.85	5.0	5.2
Based on Monthly Inventories	*	2.4†	2.7†	3.4	3.75	3.75	3.85	4.2	4.6	4.5
Pay Roll of Salespeople	*	*	*	*	*	7.0 %	6.5 %	6.15 %	6.15 %	5.7 %
Sales/Total Employees	$5,600†	$6,900†	$7,500†	$6,600†	*	$6,600†	$7,000†	$7,300†	$7,600†	$7,800†
Sales/Number of Salespeople	10,200†	9,800†	10,500†	10,500†	*	12,100†	14,100†	16,200†	18,100†	21,500†
Salespeople/Total Employees	74.0 %†	70.5 %†	71.5 %†	63.0 %†	*	54.5 %†	49.5 %†	45.0 %†	42.0 %†	36.5 %†
Real Estate Costs/Square Feet of Total Space	*	*	*	$ 0.55†	$ 0.70†	$ 0.60†	$ 0.74†	$ 0.80	$ 0.80	$ 0.88
Sales/Square Feet of Total Space	*	*	*	$16.00†	$19.00†	$17.50†	$19.00†	$20.00	$21.00	$21.00
Sales/Square Feet of Selling Space	*	*	*	23.00†	27.00†	27.00†	31.00†	37.00	42.00	57.00
Selling Space/Total Space	*	*	*	70.5 %†	71.0 %†	65.0 %†	61.5 %†	54.5 %	50.0 %	37.0 %

[1] In some instances, covering the operations of more than one establishment.

[2] Computed from the common figures for gross margin, alteration and workroom costs, total retail reductions, and cash discounts received.

[3] Comprises rentals, taxes, and insurance paid on leased real estate, plus depreciation on leasehold improvements and leasehold valuation, and taxes, interest, insurance, and depreciation on owned real estate.

[4] Excluding taxes on real estate and Federal income taxes, but including pay roll taxes and such taxes on sales or gross income as the stores were unable to collect directly from their customers.

[5] Except on real estate.

[6] Includes tenancy charges on buying offices, and central office expense of stores belonging to ownership groups.

* Data not available.

† Based on figures from less than 75 % of the reports.

Source: Harvard Business School, Bureau of Business Research, Bulletin No. 115, *Operating Results of Department and Specialty Stores in 1941*, by Charles A. Bliss (Boston, the Bureau, 1942), Tables 4, 7, 9, and 14, pp. 10, 15, 18, and 23.

APPENDIX E

Operating Figures for 41 Limited Price Variety Chains: 1941
(Net Sales = 100%)

Items	Aggregate Figures: Amounts (Dollar figures given in thousands)	Aggregate Figures: Percentages Computed from the Combined Dollar Figures of the 41 Chains	Median[1] and Range Figures (Percentages Computed from the Figures in Each Chain Taken Individually): Median[1] Figures	One-half the Reported Figures, Centered on the Median, Lay between the Limits Listed Below	
Aggregate Number of Stores	5,813	....	5,813		
Aggregate Net Sales	$1,115,322	100.00 %	$1,115,322		
Average Net Sales per Chain	$27,203				
Average Sales per Store	$192				
Index of Change (1941/1940):					
Number of Stores per Chain	....	....	100.00	100.00	103.08
Net Sales per Chain	....	....	116.65	112.18	125.92
Average Sales per Store	....	....	115.54	110.82	120.96
Net Sales in Identical Stores[2]	....	....	114.31	111.74	121.06
Net Cost of Merchandise Sold (including freight, express, postage, and truckage)	$709,787	63.64 %	63.66 %	62.25 %	65.71 %
Gross Margin	405,535	36.36	36.34	34.29	37.75
Salaries and Wages	$161,814	14.51 %	16.64 %	15.33 %	18.49 %
Tenancy Costs	92,801	8.32	5.29	4.35	7.04
Light, Water, and Power	11,024	0.99	1.06	0.86	1.23
Depreciation of Fixtures and Equipment	8,491	0.76	0.87	0.73	1.08
Supplies	9,872	0.89	1.08	0.89	1.31
Advertising	2,532	0.23	0.29	0.11	0.56
Insurance (except on real estate)	4,093	0.37	0.42	0.32	0.53
Taxes (except on real estate or income):					
Sales	1,371	0.12	0.03	0.00	0.16
Other	11,548	1.03	1.11	0.91	1.31
Miscellaneous Expense	14,453	1.29	1.41	1.06	1.87
Total Expense before Interest	$317,999	28.51 %	29.04 %	27.59 %	31.45 %
Total Interest	16,707	1.50	1.50	1.28	1.67
Total Expense including Interest	$334,706	30.01 %	30.24 %	28.97 %	33.38 %
Net Profit or Loss	$70,829	6.35 %	5.60 %	4.03 %	6.78 %
Total Net Other Income	30,509	2.74	2.05	1.51	2.41
Net Gain before Income Taxes	$101,338				
Percentage of Net Sales	....	9.09 %	7.40 %	5.59 %	8.95 %
Percentage of Net Worth[3]	....	20.44	26.55	18.89	34.43
Rate of Stock-turn (times a year, based on monthly inventories)[4]	....	4.17	3.48	2.83	3.98
Total Markdowns and Shortages	*	*	2.04 %	0.97 %	2.25 %
Freight, Express, Postage, and Truckage	*	*	2.20 %	1.70 %	2.93 %

[1] All the medians were set independently; therefore the sum of the individual items does not necessarily equal the total.

[2] Data on stores operated continuously for 24 consecutive months were provided by 29 of the 41 chains.

[3] The figures for this item were based on the reports of the 39 chains giving balance sheet data.

[4] The figures for this item were based on the reports of the 28 chains giving usable monthly data.

* Data not available.

Source: Harvard Business School, Bureau of Business Research, Bulletin No. 116, *Expenses and Profits of Limited Price Variety Chains in 1941*, by Elizabeth A. Burnham (Boston, the Bureau, 1942), Table 4, p. 5.

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ALPHABETICAL LIST OF CASES